

# THE DOLLAR CRISIS

CAUSES AND CURE

*A Report to the Fabian Society*

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TO  
LORD LINDSAY OF BIRKER  
WHO NEVER QUITE COULD CONVINCE ME THAT  
OXENSTIERNA HAD THE WHOLE EXPLANATION, IN  
GRATEFUL ACKNOWLEDGEMENT OF YET ANOTHER  
TYPE OF DEBT THAT CANNOT BE REPAYD





## PREFACE

### THE PSEUDO-SOLUTION OF WASHINGTON

THE present essay in international economic co-operation grew out of a lecture to a Fabian conference which was to have been printed as a pamphlet. It was written in the conviction that only the most searching self-criticism and a thorough change in mentality, and consequently in policy can rescue the Labour Movement in Britain, indeed in the West, from its present loss of initiative and prevent its ultimate self-stultification despite electoral victories. The weakness of the case of its opponents will not produce results in reaching its goals.

The writing was completed in July 1949; since then much has happened. But the recent events and incidents merely illustrate and strengthen the main conclusions. There is no reason, in particular, to withdraw or modify the arguments against (even a general) devaluation of the non-dollar currencies.<sup>1</sup> The basic principle that economic policy is supposed to aim not merely at an increase of total production but also of the equality of distribution seems to have been completely lost in the welter of abstract nouns. Faced by the Communist challenge, the West must not lose sight of the basic strategy of its resistance. The new 'solution' devised at Washington—the sole important operative point being the devaluation of the pound—cannot be considered, as we shall argue, as more than yet another of those 'shots in the arm' which provide a questionable temporary relief for the unbalance in international payments; but in this case—unlike the Loan to U.K. or Marshall Aid—at the cost of the poor both nationally and internationally. It does not tackle the fundamental problems of the Western World and provide a firm basis for the resistance to Communist advance. Nor should we be complacent about the repercussions of what has happened, and how it happened, on the prospects of that closer co-operation in Europe upon which ultimately Britain's fate as much depends as that of the Western Continental countries.

We shall try to relate these events to the conclusions arrived at in the main body of the present essay.

<sup>1</sup> Cf. Chapter 4, esp. pp 86-8.

Most of the comments spread in print, and over the air by a supposedly unbiassed public corporation, before and after the devaluation of sterling seem of an oddly misleading character. The strange phenomenon that the Government's case is given a wholly insufficient expression still persists. Baulked in their desire to impose deflation on Britain, and to enforce a decisive increase in social inequality, a new attack on sterling is being prepared, supported by arguments which at least the more intelligent of the protagonists know not only to be untrue, but the opposite of the truth. It is of the utmost importance that this should be understood and acted upon. Evolutionary reform movements have their own tragic dynamism—indeed not less tragic than that of revolutions. In trying to avoid violence and arrive at a compromise with the former ruling classes, Centre parties often lose their popular support which thereupon turns to more extreme movements. The subsequent polarization of political opinion might then result in a violent clash or at least in the decline of democratic institutions. A renewal of the speculative attack on the pound is openly threatened unless the Labour Government capitulates and reverses its social and economic policy. The Right accepts no compromise. All this shows how ignorant is obscurantist orthodoxy of its own longer-run interests and how far it is from realizing that it can no longer dictate the destinies of Western nations contrary to the welfare of the broad masses.

#### BRITISH POLITICS AND THE ATTACK ON STERLING.

The success of the speculative attack on the pound, encouraged, if not engendered, by the perhaps thoughtless rather than malicious prattle emanating from high circles in Washington, and strengthened by the constant attacks on the British Government at home and abroad, has even in this country deflected attention from the long-run economic strategy of the Western World to the immediate difficulties of the Sterling Area. Even in this, the less relevant aspect of the general Western malaise, a completely misleading picture was foisted on an eagerly receptive Conservative public. The rôle of the American recession, of the increasing flight of capital, the importance of the refusal of the entrepreneurial classes to reduce export prices *pari passu* with the fall of labour costs due to the continued

increase in productivity in the last three years, and the incapacity of Government controls to enforce pressure without general unemployment—all this was suppressed. What might be termed the impressionist school of economists and publicists, which, after their rapturous bout of surrealist phantasy engendered by the fuel crisis<sup>1</sup> has suffered its well-deserved shaming when global post-war statistics were first published in 1948, have felt the call again. It is the disproportional increase in wages and social services that is blamed for the crisis.

The overall increase in productivity since 1947 is over 14 per cent.

	(1947=100)				
	1948				1949
	I	II	III	IV	I
Employment	104	104	105	105	106
Output	112	112	106	117	121

Wage-rates on the other hand only increased 8 per cent since the middle of 1947 and have been practically stable since the beginning of 1949. If anything labour costs in this country have declined. Wage-costs in the United States have risen considerably with—as yet—little increase in productivity being discernible.<sup>2</sup> Wholesale prices rose considerably more than in the U.S.: 198·3 (manufactures) in July 1949 (1937=100) as against 172 in the U.S. The discrepancy between the export-price indexes is even greater, 191 (1938=100) as against 250 in Britain. To what, then, is this discrepancy due? The increase in the price of imports due to the diversion of purchases to the sterling or soft currency area plays some part in it. There can be no doubt, however, that it was more due to high profit margins than any other factor. Total known profits of private enterprise (before taxes) have risen to some 250 per cent of pre-war and we know that tax-evasion is far greater now than it has ever been before. The rise in pure profits per unit of capital is even greater: to just under 275 per cent of pre-war. This compares with

<sup>1</sup> Cf. Appendix III

<sup>2</sup> Cf. Chapter 1. The E C E calculation, based on pre-war weights for comparability, comes to the conclusion that between 1946 and the first quarter of this year labour costs (including social services) rose from 155 to 158 only in this country (1935-8=100) while in America they increased from 171 to 200. The use of post-war weights can hardly alter this result to the detriment of the U.K. by as much as 5 per cent. As in all calculations of complex index numbers weights must be chosen, our 'impressionists' now suggest that all statistical evidence is fictitious.

a rise to only 185 per cent of the return to labour. If the margins of profit had not risen as compared with pre-war, prices could have been reduced by as much as 7 per cent overall and considerably more in certain sectors.<sup>1</sup> The fact that profits bear a heavy tax, that social inequality is not much increased by their inflation, does not detract from the vital urgency of the need to reduce them—if for no other reason to enforce the elimination of inefficient entrepreneurs and increase productivity. At full employment the more modern firms can only attract labour if others are forced out of business.<sup>2</sup>

Confronted with this evidence, the impressionists take refuge in personal 'experience'<sup>3</sup> or hearsay. As all statistics are subject to some margin of error it is suggested that they might really mean the opposite of what they patently indicate. As statistical methods increase in accuracy and statistical information in volume, this sort of *ex parte* argumentation will, if not decline in publicity, at least be shown up for what it is.

This colossal bluff to some extent even hoodwinked the Government. A heavy price indeed is being exacted in terms of social justice for the failure of the Government to organize statistical services (Chapter 5, Section (b)) and reorganize the administrative machine (Chapter 5, Section (d)) in order to give effect to its principles. The very fact that devaluation, which makes the poor countries poorer and the rich richer, which makes the poor in the poorer countries poorer and the rich richer, should in fact amount to a substantial victory of the progressive cause in British Govern-

<sup>1</sup> Cf. T. Barna, Those 'frightfully high' profits. *The Bulletin of the Oxford Institute of Statistics* Vol. II, Nos 7 and 8, 1949. This devastating critique of the most popular fallacies has not received sufficient attention even by the Government. Cf. Chapter 5, esp. pp. 111-13.

<sup>2</sup> Cf. Chapter 5, pp. 96-110 and 114-29, Appendix III on the dangers of 'consumption socialism.'

<sup>3</sup> One of the more amusing instances is the attempt to rebut the carefully compiled statistics of F.A.O. on food consumption. These show that the supply of high value foods (milk, meat, etc.) per head was much higher in Britain than in the *laissez faire* countries. This is countered by reference to the superiority of restaurant meals on the Continent. In addition averages mean nothing on the Continent: the discrepancy between the poor and the rich is so great. It is even argued by some that, because the British equality is due to rationing, it does 'not contribute to the common good' as it 'restricts personal choice' so severely. An odder use of the word 'common' in this context can hardly be imagined. And one wonders whether the mass of undernourished children in Italy looking at the vigorous consumption of whipped cream ('average' consumption of milk and cheese in Italy being 29.7 gr. as against 50.7 gr. in the U.K. despite the much greater use of cheap cheese in cooking) derives much pleasure from the personal choice others have (cf. the discussion on the relationship of rationing to monetary policy, Chapter 5). The modern critical discussion of welfare economic concepts seems to have had no impact on most economic experts and commentators.

ment circles throws an odd light on the nature of the alternative solution which must have been proposed by its own advisers.

The protests of those least capable of bearing the burden against the imperfect justice consequent on devaluation might further weaken the cohesion between the rank and file and their representatives in power. Their mutual impatience with one another might easily grow with grave consequences to the future of the progressive movements in Britain and Europe.

It is in the disillusionment and the consequent apathy of the mass of the population that the danger for Western Europe arises. The Conservative case can hardly benefit from the mistakes of the Labour Government, as it is amply evident that such setbacks as Britain has suffered were not the consequence of the application of the principles of social and economic justice on which the Government received its mandate in 1945. On the contrary, they are the result of its hesitation in foreign and domestic policy to give effect to those principles and of its failure to work out clearly their day-to-day implication on the conduct of affairs. In foreign policy a substantial and unnecessary burden was imposed by mistaken execution rather than a faulty conception. At home the apparatus of control was repeatedly weakened.<sup>1</sup> Nor was adequate administrative machinery evolved to sustain the strain of the transition to a stable economy. And, while in international economic affairs especially its advisers were permitted to squint hopefully towards the sweet simplicity of the uncontrolled sway of speculative markets, in internal policy the Government remained pledged to maintain full employment and to improve social justice. Not the profligacy of policy but its unco-ordinated nature accounts for most of our disappointments—so far as they are due to domestic rather than foreign causes.

Fortunately, in trying to magnify the Government's failures and to put forward alternative policies, the opponents of progressive evolution in this country have betrayed themselves and given their case away. It is easy to be lulled and lured by the gentle generalities of Mr. Eden or the patriarchal woolliness of Lord Woolton. It is quite a different proposition to be told by a serried rank of 'experts' that the 'optimum allocation of resources,' 'the desirable flexibility of the system' requires mass-unemployment of at least between

<sup>1</sup> Cf. Chapters 1 and 5, and Appendices I and III.

one to two million.<sup>1</sup> This irresistible urge for self-expression of what one might describe as the inverted vulgar-Marxian school of economists will deal a death-blow to the hopes of the Labour Government's opponents. They wish to substitute for a balanced society and the patient work toward compromise solutions, an open class domination achieved by deflationary policy. No one can have any doubt about the real intent of the opposition if only because such free rein has been given to these views. The smattering of economic knowledge acquired by the younger members of the Conservative Party which made them propose to let the value of the currency float freely to find its natural level (whatever that may mean),<sup>2</sup> to let controls rip and to abandon the policy of income stabilization, has given the show away. The loud protests of the less logical but intuitively far superior old guard against policy statements are quite comprehensible. No denial can get the Conservative Party over the fact that a substantial cut in Government expenditure, the central feature of their plans, can only be achieved at the expense of defence or social services. No one believes that they intend to pare down on defence. The conclusion is obvious.

In the same way decontrol and abandonment of conscious income-stabilization without inflation is only conceivable if the bargaining power of the Trade Unions is smashed. Decontrol and the remission of taxation would violently decrease the share of wages and depress the standard of life of the poor when the rich are relieved from direct taxation.<sup>3</sup> Does anyone in his right mind suggest that such a programme can succeed without first breaking the power of resistance of the Trade Unions? And above all, will anyone in his right mind believe him?

No, the campaign of the orthodox economists against the Government, taken up with such glee by the Opposition, their attempt to discredit it in the U.S. and Europe and to enlist American aid for a complete reversal of policy, must consolidate the position of

<sup>1</sup> Cf. Chapter 5, Section (a), esp. p. 106, note 2.

<sup>2</sup> This proposal was contrary to the Bretton Woods agreement which has been enacted by Parliament with the support of the greater part of the Opposition. In the absence, moreover, of strong reserves, speculative attacks might well justify themselves *ex post*. Moreover the 'true' value of the currency is determined by employment as well as prices and wage-rates. 'Freedom for the pound' might well lead to cumulative inflationary or deflationary processes. The whole incident shows the weakness of the primitive theory based on static assumptions and sedulously propagated by the orthodox 'experts'.

<sup>3</sup> Cf. below, p. 104, on the strange contradictions which are at the basis of that fashionable view on 'incentives.'

Labour. It shows only too clearly that the Government's relative failure in administration was due to their lapses from their own principles, to their listening—in their unnecessary quest for fleeting popularity—to the ill-conceived advice of their adversaries. The coming election will be decided on the issue of full employment and social security. The critical position of the country increases rather than decreases the vital importance of the victory of the progressive cause. Once this is understood—and the orthodox school at any rate have done their best to warn the country of their intentions—the outcome cannot be uncertain, despite the complete failure of the Government to put its case effectively except in ill-reported speeches. The burning question is: what use will be made of electoral victories?

#### DEVALUATION AND THE DOLLAR CRISIS

It is not really in terms of British politics that the events of the last three months must be deplored: it is from a general Western point of view, from the point of view of an effective resistance to Communist infiltration, that this turn of events is lamentable. The remarkable recovery of 1948 on the one hand and the collapse in China on the other, each in its way, provide a lesson. The West should have concentrated on the solution of the basic economic problem of the free societies, the international maintenance of full prosperity and increased social justice. The balance of international payments would partly have followed and, in so far as weak spots still remained, could have been rectified without undue strain being suffered by those least able to bear it. Instead the attention of the world was deflected to the unbalance of international payments, without regard to the immediate causes of that unbalance or the longer-range consequences of certain measures, e.g. devaluation, which were vociferously pressed by the orthodox economists.

In domestic economic policy few doubt the necessity to mitigate the harsh social consequences of the uncontrolled sway of markets based on an unequal distribution of wealth. In the U.S., as in all other industrial countries, progressive taxation and the provision of social services ensure such modification of the outcome, such measure of social justice as corresponds to the interplay of political forces in the country. So long as economic inequality and political

democracy coexist a steady growth of social legislation is inevitable. Only a dictatorship could alter the trend, and suppress the demands of an increasingly organized and articulate working class.

It also is admitted—though perhaps not as generally—that inequality of income and increasing wealth tend to increase the difficulties of maintaining stability. A mature economy, if not subject to planning, probably—to say the least—needs ‘outside’ stimulation, i.e. stimulus not originating in the profit motive. Whether this stimulus is given by social services financed out of redistributive taxation or by loan expenditure on ‘non-competitive’ projects, e.g. roads, is another problem—largely determined by the ruling political and social ideology of the community.

Strangely enough these twin considerations were never applied in the field of international economic policy. Yet the war and its disastrous consequences on Western Europe, the rise of the U.S. to a position of hegemony in the West (and industrially in the world as a whole) unprecedented since the days of Rome, the growing divergence between rich and poor countries suggest that their application is most needed there. The dollar problem is not of a transitory nature; nor can it be solved by ‘orthodox methods’ without aggravating the malaise not only of the world but even of the U.S.<sup>1</sup> The dominance of the old-fashioned theory or rather sentiment based on highly artificial assumptions is such that it has hardly been challenged even by progressive thinkers and politicians.

The most tragic aspect of recent events is that the basic economic strategy of the Western World has been lost from sight. Despite President Truman’s striking victory over those same interests and opinions which vilify the present British Government and attempt to undermine its policy, he has permitted them in recent months to dominate the foreign economic policy of his administration. In war as in peace defeat is all but inevitable if the enemy is permitted to choose his own battlefield and dominate one’s mind. The conservative forces in America and Western Europe were able to choose the technical problem of monetary readjustment to fight the last round in a long-drawn campaign for a post-war settlement of the Western economic problems. The consequences on welfare and on economic stability were disregarded. Nor was the future clearly envisaged

<sup>1</sup> Cf. below, Chapters 1 and 4, as well as Appendix II



despite the clear formulation of the problem by the painstaking surveys of the Economic Commission for Europe.<sup>1</sup>

The overall deficit of the world to the United States in 1948 was \$7.8 billion. Of this Europe incurred only \$3.6 billion. The unbalance was bridged, however, by Marshall Aid in the last quarters of 1948 and the first quarter of 1949. In the second quarter the United States once more began to gain gold: \$320 million of which the sterling area accounted for as much as \$260 million. The excess of visible exports increased from \$1.5 billion in the first quarter of 1949 to \$1.75 billion in the second quarter: mainly as a result of the reduction of imports (\$190 million) and a slight rise (\$40 million) of exports. Imports from the sterling area—mainly sensitive raw materials—were, of course, hit much harder (18 per cent)<sup>2</sup> than general imports (11 per cent). The increase in exports was mainly destined to Canada (\$100 million) and the sterling area (\$60 million). The import controls of these countries were not working well; and demand in the rest of the world was by and large declining.

It is clear, therefore, that the economic causes of the 1949 dollar crisis originate in the main in declining U.S. business activity and in the maintenance of employment coupled with decontrol in the sterling area, while the *laissez faire* part of the world followed the U.S. recession. An attempt to deal bilaterally with the problem of the sterling area deficit by devaluation as suggested by the U.S. Treasury necessarily had grievous repercussions on the other industrial areas of the world: it had to be sufficiently drastic to readjust a balance with the U.S. which was worsening, while that of the rest of the world improved, because the sterling area continued full employment when other countries were already showing signs of spreading depression. It could not be expected, however, that the main industrial countries would remain on the old, pre-devaluation, parity since, if they had, the sterling area relations with them would have got out of hand.

The change in the terms of trade in favour of the U.S. as a result of the general devaluation, however, could contribute little to the

<sup>1</sup> Cf. below, Chapters 1 and 2.

<sup>2</sup> U.K. exports to U.S. declined by £23 million between the last quarter of 1948 and the first quarter of 1949 and increased subsequently by £3 million. The sterling area deficit (before Marshall Aid) increased from £82 million to £157 million. The U.K. visible deficit increased by £27 million in the same period.

stabilization of the Western World. The fall, in terms of dollars, of raw material prices is hardly likely to increase demand. It is even uncertain whether it will result in a proportionate fall in the price of final products. It is more likely that it will be used to buttress the failing profits of U.S. business. Hence the establishment of stability in the United States will be postponed as savings will tend to increase without any corresponding increase in investment.<sup>1</sup> On the contrary the threat to U.S. exports in consequence of devaluation might increase the caution of U.S. business to enter into long-term fixed capital commitments.<sup>2</sup> Basically the method of coping with the present minor dollar crisis pressed by the U.S. Treasury is bound to accentuate the longer-run problem, the problem of the eventual dollar balance.<sup>3</sup> No doubt it would be possible to offset this tendency by a suitable alteration of U.S. domestic policy.

Unfortunately it is by no means certain that such reconsideration of internal American policy, which if applied betimes might have avoided<sup>4</sup> the recent disturbance, is more likely in the next few months. The decline in U.S. business activity, the main cause of the present crisis, seems to have come to an end. The orthodox experts whose complacency was somewhat shaken in the beginning of the summer of 1949 seem to have recovered it again.

Economists have long recognized that fluctuations in working capital (i.e. in stocks of commodities held by merchants and manufacturers) are one of the most important causes of instability in general. The reduction of these stocks reduces production below the level of current consumption, and thus creates unemployment. Addition to stocks represents investment and thoroughly accentuates booms. It has also been recognized that in the short run the instability of working capital due to speculative anticipations might exert an influence altogether disproportionate to the basically more important fluctuations in fixed capital because the reduction and accumulation of stocks can be undertaken at short notice.

<sup>1</sup> In 1932 British recovery was based on a housing boom. It gathered force only very slowly and did not to any extent diminish pressure in the peripheral countries.

<sup>2</sup> On the implications of devaluation on U.S. imports, cf. below, Chapter 4, pp. 84-5. The objections against devaluation were less than could be expected.

<sup>3</sup> The change in terms of trade will increase the inflationary tendency in the non-dollar areas. The basic unbalance has not been eliminated. It merely assumes a new form. Cf. below.

<sup>4</sup> Cf. Chapter 4 on the contradiction between current orthodox advice and the 'classical' system of readjustment on the basis of which it is reputedly framed.

Stocks of commodities cannot be reduced below a certain level. Even if there is no restocking, the end of destocking means an immediate spurt in production as consumption is no longer satisfied by reducing stocks. Thus the appearance of a recovery is given.<sup>1</sup> This is what seems to have happened in the U.S.A. Whether this recovery is merely a transient flash, or more solid, depends on whether or not fixed capital investment is maintained or continues to decline. Should the initial slump in circulating capital spread to fixed investment, or rather, should the much slower decline in fixed investment continue, the recovery is doomed to frustration and the system is carried to new lows. It should be added, moreover, that the slump will be slower to materialize in fixed capital investment than in circulating capital, as most fixed investment projects take time to complete, and unless a financial crisis occurs, people who have embarked on such projects will do their best to complete them so as to avoid total loss.

The financial position in America is obviously strong and the latter contingency can, at this stage, be ruled out. The problem is, therefore, whether, the de-stocking slump having ended, the American economy will resume its upward trend. Some hope can be derived by the expansion in public and private construction. Given the fact, however, that even shortages in the heavy industries and in automobiles are being overcome at the moment, owing to the tremendous volume of post-war investment, one might express some scepticism and wonder whether, after a transient recovery in the autumn, the downward trend will not continue.

Nor is the wave of devaluations of non-dollar currencies irrelevant in this respect. It is bound to exert some deflationary pressure in America as American exports are excluded from third markets and as the volume of imports (even if not their total value) increases. The quantitative effect of these changes on the U.S. economy is not decisive, however. The disproportion between the U.S. economy and that of the rest of the world is so great that the internal factors will decide the trend. But these will have to contend with this additional unfavourable shock.

The probability is that the American slump will be aggravated. The present slight recovery might in fact worsen the eventual

<sup>1</sup> Between the autumn of 1929 and the low-level in activity reached in 1932 there were two rebounds. The first of 4 per cent occurred early in 1930, the second of 5 per cent a year later. Both were vociferously greeted as heralding the return of the 'New Era.'

position, as it will give a sense of unhealthy security to, and strengthen the influence of, opponents of even the mildest Liberal-Keynesian anti-cyclical policies. This contingency is, however, still remote. For some months American demand might be expected to remain at its present level or even increase slightly.

With the return of the economics of Bedlam, proposals which under rational conditions would have to be considered silly have again come to the forefront. The proposal to revalue gold in terms of dollars or the well-meant effort of a committee of the Food and Agricultural Organization of U.N. to establish a food-clearing centre to take over 'surplus' produce show how far we have slipped back into the 1930s. If the problem of the inequality in the international distribution of wealth and income were tackled, such surpluses would hardly appear. Indeed, we should be faced with 'shortages.' The F.A.O. plan shows how docilely even progressive experts accept as inevitable the continuation of deflationary policies which render the emergence of 'surpluses' inevitable.

Mr. Truman, by his speech in Philadelphia, was successful in creating an atmosphere of friendly co-operation and dissipating the acrimony due to the hostile propaganda, ably abetted by their British and Continental henchmen, of U.S. vested interests afraid of the success of the British experiment. His inaugural address also shows that he is aware of the ultimate line of approach to the solution of the crisis of the Western World. Unfortunately, as the Washington agreements demonstrate, he has not been as successful as one might legitimately have hoped in giving effect to these principles.

The success of the Administration in obtaining Congressional approval to further sacrifice, and acquiescence<sup>1</sup> in concessions to Britain, such as the release of Marshall Aid funds for purchases in Canada, transient as they are,<sup>2</sup> shows the same ominous dependence on yet another turn in the course of the cold war. The Chinese debacle and the sudden announcement of an atomic explosion in Russia seem to have, once more, worked wonders for Europe. The increase in tension and the increasing precision of military arrangements contrast sadly with the highly unstable basis of economic

<sup>1</sup> The atmosphere was very different after the relative success of the Four Power Conference at Paris Cf. Chapter 4, pp. 84-5, and note 2, p. 85

<sup>2</sup> Nor do they lighten the overseas burden of military and similar commitments proportionally to the British capacity to bear them. Cf. below.

co-operation and of European recovery on which the success of all military resistance depends. The vital rôle of economic factors in the overall strategy of the Western World is still not recognized. Indeed, a certain impatience is being manifested in influential Senatorial circles at the presumption of Western Europe of putting recovery first—which, unfortunately, is not even the case. It is to be hoped that the process of enlightenment will proceed at a quicker pace than hitherto and become less dependent on the day-to-day fluctuations in the cold war. From the point of view of Europe's future, defence must remain a deterrent and not constitute a menace which might provoke.

## DEVALUATION AND THE BRITISH PROBLEM

As we demonstrate below<sup>1</sup> the sudden worsening of the sterling balance of payments was caused by the release and flight of capital coupled with a speculative attack on sterling and, what is at least partly connected with it, a substantial increase in imports of the sterling area. Both were to a considerable extent the result of the breakdown of controls in parts of the sterling area and the thoughtless decontrol in this country coupled with the failure of the Bank of England to institute some control over capital movements within the sterling area. There was no disproportionate increase in labour costs and the increase in Government expenditure—with the exception of direct expenditure abroad mainly on account of increased military commitments and related burdens—had only a tenuous, indirect effect on the balance of trade. The overall balance of payments was maintained until the middle of the year without any appreciable rise in wages or prices or the emergence of shop-shortages. The reduction of exports was mainly due to the worsening of the economic position abroad and the anticipation of devaluation. A reduction of export prices, however, by a reduction of profit margins, might have countered this in third markets at least. From an internal point of view the increase in profit margins was deplorable because it retarded the weeding out of the inefficient producers and had an unfavourable influence on the distribution of incomes. It did not constitute, however, a *direct* threat of cumulative inflation. Nor can it be assumed that disinflation would be effective

<sup>1</sup> Cf. Chapter 5, Section (c).

in reducing gross profit margins in contrast with net profits. The decontrol of certain raw materials, e.g. paper, caused some bottlenecks in the lower stages of production. Others, e.g. labour for the mines, were accentuated by mistakes in location policy and by the failure to use the building programme to promote labour mobility. These are not problems, however, which could be dealt with by general measures such as deflation without disproportionate losses and hardship. It is obvious, however, that the abandonment of discriminating controls, including control over engagements, can only be undertaken at the risk of having to institute a sharply deflationary policy subsequently.

Liberal economists unaccustomed to peer beyond the narrow confines of their strange imaginary world usually get hold of the wrong end of the stick. The problem of the so-called 'unrequited exports' has been no exception. They directed their attacks on the release of the wartime accumulation of blocked sterling balances and attributed the exchange crisis mainly to its extravagance. In actual fact the balances of sterling area countries decreased by £230 million in the last three and a half years.<sup>1</sup> In view of the threatening position in East Asia and the immense economic difficulties of India, Pakistan and other countries in the same category, these payments must be regarded as part of the combined defence expenditure of the Western World and should have been dealt with accordingly.

The legal export of capital to the sterling area, however—which results in creating new sterling balances and thus absorbs exports—was almost £450 million.<sup>2</sup> This was almost twice the drain due to the release of blocked sterling area balances. It must be borne in mind that investment in British oilfields unaccountably was recorded in the invisible current account and that Government transactions are excluded. The 'legal' export seems therefore to cover some very odd 'investments.' Once in certain parts of the sterling area, capital can easily be exported further or used in those semi-legal or illegal transactions by which dollar proceeds are diverted from the Central Banks. The illegal export of capital, mainly through under-invoicing exports and overpaying for imports, can hardly have been

<sup>1</sup> Cmd 7648 and 7793. The net release in the first half of 1949 was £98 million or almost two-fifths of the total. The net release of all balances amounted to £430 million. This, however, includes balances which did not arise out of the war. A large part of the sterling area releases was used for capital repayments and did not burden the current balance.

<sup>2</sup> *ibid.*

less than £200 million and might have been far larger. The quasi-legal increase in the imports of raw materials due to lax control is an additional important item even in this country. In the more outlying areas of the Commonwealth it has grown to formidable proportions. The fall in manufactured exports does not account for a large proportion of the worsening of the balance.

Last but not least, the direct military expenditure and relief including Germany, but excluding unrequited exports to India, etc., which properly belong to this category, in these three years amounted to some £1,013 million, and are, after a dip in 1948, again steeply rising. Moreover, defence expenditure at home also necessitates greater imports than other Government or private expenditure. Petrol, oil, other imported raw materials and food constitute a much greater proportion of this expenditure than of outlay generally. Moreover, manpower in the defence forces is prevented from contributing to the export drive. Hence the burden is positive as well as negative.<sup>1</sup>

It is the imperfection of control rather than internal economic causes which forced the pound off its parity. A maintenance of a higher rate of exchange combined with effective control would have yielded much better results from the point of view of the standard of life outside the dollar area.<sup>2</sup> Once 'confidence' was shaken the relative abundance of sterling funds held abroad precipitated the crisis. A stiffer web of controls, and continuous close co-ordination of economic and financial policy with the Commonwealth—instead of spasmodic emergency meetings—could have prevented most of the deterioration. Devaluation, in order to have any chance in arresting the speculative attack without tightening controls, had to be of substantial proportions: not only must it adjust the current balance in unfavourable circumstances, but it must deter further speculative sales. The existence of organized black markets in sterling abroad made it necessary to devalue sterling even more sharply. The sharper the devaluation, however,

<sup>1</sup> Cf. Appendix III.

<sup>2</sup> Out of total U.S. imports from the sterling area, including the U.K., of \$1,328 million in 1948, \$204 million was represented by whisky, cocoa, fats and other vegetable products, \$251 million inedible vegetable products, \$408 million of fibres (mainly wool), \$110 million of non-metallic minerals. U.K. exports (in which whisky was one of the most important items) only amounted to \$280 million. U.S. exports of machinery, vehicles and chemical products to the U.K. in 1948 amounted to \$179 million, to India and Pakistan \$143 million, to South Africa \$251 million. The South African deficit with the U.S. at \$355 million was heavier than the U.K. deficit (\$273 million).

the greater the shock abroad, because the value of the currency must be depressed below the level corresponding to relative costs. The potential unsettlement at home due to the increase in the price of necessities and the increase in profits on exports will also be proportional, as also the loss of real income due to the worsening of the terms of trade. Hence the short and long run considerations in fixing the new parity conflict.

Such, then, was the position which the Anglo-American Conference in Washington was called upon to face. If the somewhat general official statement is to be taken at its face value, the main immediate cause of the loss of reserves, the decline in U.S. business activity, and the spread of deflation to parts of Western Europe was either disregarded or relegated to that somewhat shadowy place which it occupies in the previous post-war agreements where all participating countries pledge themselves to maintain full employment. Undoubtedly the assumption that business activity will revive in the U.S. must have been implicitly the basis of the specific measures envisaged.

These practical steps include<sup>1</sup>:

- (a) the devaluation of the pound;
- (b) permission to use E.R.P. funds for the purchase of Canadian products despite the emergence of U.S. 'surplus supplies' of the same products;
- (c) stimulus to American private investments in the Commonwealth combined with some as yet unpublished arrangement on sterling balances;
- (d) reconsideration on American and Canadian tariffs, and customs procedure, with the view of increasing imports from Europe and the Commonwealth;
- (e) consideration of commodity arrangements (including the regulations limiting the consumption of natural rubber) and stockpiling with a view to increasing the dollar-earning capacity of the Commonwealth;
- (f) permission to discriminate against hard currency imports despite the Anglo-U.S. Loan Agreement in connection with the proposed liberalization of intra-European trade.

There is no evidence that the implications of these steps on the rest

<sup>1</sup> As regards shipping and mineral oil, in the case of both of which the U.S. pursues a discriminating policy, no effective agreement was reached.



of Western Europe were envisaged or that a sharp distinction was drawn between the immediate cyclical, and the longer run structural, problem.

There is no reason, however, to follow in this procedure. We shall therefore first turn to the impact effects of devaluation. Apart from the rebound in U.S. demand due to the cessation of general de-stocking in the U.S. which would in any case have increased demand for Western European and sterling area exports to the U.S., there is an additional reason for expecting a considerable immediate increase of orders for British goods; the speculation on devaluation must have led to an even more widespread postponement of purchases in the Commonwealth than domestically. Hence the rebound will be *pro tanto* greater. Thus there should be in the next few months a considerable increase in Commonwealth exports irrespective of whether or not demand for them in the longer run will expand as a result of a fall in their price.

We must expect as a further immediate favourable effect of the devaluation the closing of speculative positions against sterling (i.e. the re-purchase of sterling by those who sold it hoping for its devaluation) and some repatriation of the capital which was legally or illegally exported. All these speculators, having been handed some 40 odd per cent on their gamble, might well be inclined to take it. Moreover, those who speculated against the pound by amassing large commodity stocks will now not need to import as much as is required by their day-to-day output as they will probably let their stocks drop in view of possible secondary price-falls. Exporters, on the other hand, who delayed the collection of foreign debts due to them in terms of foreign currencies will certainly press for payment. Thus at the cost of some scores of millions of legal, semi-legal and illegal profits to speculators, the gold reserve of the country will certainly undergo some immediate easement.<sup>1</sup>

It is improbable, however, that the basic capital flight, which originates largely in the fear of war and high taxation, will be stopped, unless the administration of exchange control is drastically improved. Indeed, the upheaval in prices caused by the devaluation will permit more evasion and further weaken the reluctant power of the authorities to supervise effectively transactions with foreign

<sup>1</sup> In the first two weeks after devaluation the gain was some £20 million.

and sterling countries. And the temporary reflux of capital will weaken the drive for real reform.

We might now turn to the longer-run aspects of the new compact. The Government's experts, when discussing the consequences of devaluation, argued that 'some fall in the standard of living would be necessary in any event. With revaluation it is small, controlled, and evenly shared. The alternative would be a heavier and harsher fall, less subject to control and bearing harder on some than on others.' If the only alternative to devaluation were a violent deflationary shock administered, e.g. by cutting food subsidies and other social services and suddenly clamping down on investment, in the hope that the consequent decrease in spending will result in a sufficient fall in *dollar* imports from or a rise of exports to *dollar* areas, this would be true. Even an improvement in the *overall* (as contrasted with *dollar*) balance would demand a *multiple* cut in outlay and employment.<sup>1</sup> In order to influence the dollar balance, spending would have to be cut by a still greater amount. Unemployment and sacrifice would be unequal and apart from the inevitable loss sustained by not having the dollar imports, Britain would sustain a much greater loss through unemployment and the fall of home production.

In the short run, therefore, this was even technically no alternative, because time was not available for the cuts in outlay to have their effect. Even had there been time it would have involved unnecessary hardships. On the other hand there was, at any rate last year, another alternative to devaluation, far superior from the point of view of non-American living standards. This was a selective control of U.S. imports buttressed by reciprocal purchase agreements between non-dollar countries and a selective stimulus—through pressure on home sales and/or subsidies—to the most favourable exports. It would have reduced the worsening of the terms of trade and used discriminating pressure on excessive profit margins to achieve an increase in exports. This third solution, however, perished on the bonfire of controls. The Government tried to postpone decisions as long as possible, hoping against hope that by doing nothing, all the possible advantages of the discriminating policies would accrue without 'wild' measures being needed.

Once it became clear that the speculative attack could not be

<sup>1</sup> Cf. Chapter 5 (a).

stopped, devaluation suggested itself, not merely by way of analogy to 1931<sup>1</sup> but also as a measure which would avoid the need for making basic policy decisions. Unfortunately this view overlooks several all-important considerations. Devaluation is not an alternative to discriminating controls, if the resulting national loss is to be minimized and if the threat to internal stability is to be reduced. The fact that devaluation had to be sharp in order to achieve its aim increases the force of this argument. The optimists leave out of account that devaluation so far as it works (i.e. so far wages do not rise) is equivalent in many respects to a direct tax on essential imports on which the poor spend a disproportionately high fraction of their income and a subsidy to profits in the export industries. Here an awkward dilemma arises. From a *national* point of view it would be essential to *raise* British *prices* as much as possible, having regard to the urgency of demand abroad. If, for example, at the pre-devaluation price all available supplies could be sold in hard currency areas the increase should be a full 42 or so per cent. In other cases, where price-concessions might tempt disproportionately higher sales, prices might be reduced with advantage. Nor could the Administration escape responsibility for these decisions, as the sluggishness and incompetence of the individual trader as well as his fear of making politically awkward high profits would militate against an 'automatic optimum adjustment.'

From an internal point of view the rise in the sterling price of exportable goods, however, means an increase in the cost of living and a threat to general monetary stability. It also represents an increase in the share of the rich in total national income, i.e. an anti-social shift in the distribution of the national income. It is true, of course, that 60 per cent of profits are taxed and a large proportion of the rest is ploughed back. But the argument that current private incomes and consumption are not affected if undistributed profits increase is not quite correct. Most of the rich consume part of their capital and ploughed back profits result in capital gains. Thus an increase in profits or a cut in direct taxation, which is increasingly advocated, would tend to have inflationary results. In any case a

<sup>1</sup> The fact that in 1931 the Labour Cabinet fell over a disagreement on deflation and its successors, pledged to defend the Gold Standard, abandoned it almost immediately and thus laid the foundation to a recovery delayed only by their own mistakes, must have been a potent argument; but then there was a huge reserve of unemployed resources, and the terms of trade improved.

steep rise in profits (and the increase in the price-level of which it would be one result) would certainly lead to wage demands and result in a recurring cumulative spiral. So long as wage stability is not menaced no threat of cumulative inflation arises. Conditions must therefore be created in which wage stability can be maintained. Hence measures should be taken to restrict the rise in 'essential' prices as much as possible by squeezing profit margins, to strengthen the controls necessary to prevent a diversion of resources into non-essential home production and to channel such excess demand as might arise towards innocuous outlets which do not absorb productive resources, or to absorb it by an increase in taxation (perhaps mainly on luxury consumption). The experience in Continental countries suggest that, in the absence of effective control, only a substantial unemployment can in these circumstances prevent the start of an inflationary spiral, which will threaten the new parity.

The administrative task has not been made easier by devaluation. Without it the Government would have had to ensure a decrease of export prices while maintaining home prices. Now the problem is to keep domestic prices from rising while export prices must be allowed to increase as much as possible.

Ingenious calculations have been made to show that a cut of a given amount—between £250-600 million, according to the allegiance of the guesser—would bring the domestic monetary position into equilibrium without such complications. It appears that these calculations are based on the estimate of our overall and dollar deficit and of the adverse movement of the terms of trade. They assume that an improvement of the balance would reduce the volume of supply available to the home market by the same amount: hence monetary demand should be cut by the same amount. This is to be achieved by a retrenchment in Government expenditure and a limitation of investment.

But as we have already mentioned, and argue more fully in Chapter 5, an indiscriminate pruning of Government expenditure or of investment would result only in a fractional decrease in the demand for imports and a fractional increase in exports: most of it would be exhausted in either diminishing Government revenue or a decrease in the rate of 'innocuous' expenditure (e.g. cinemas or beer) which will not set exports free. Most calculations of the inflationary 'gap' disregard the complexity of the secondary reper-

cussions of the policies they propound. Equally the rise in the long-term rate of interest (i.e. the sharp collapse in gilt-edged prices), which has been permitted will not sensibly diminish the flight of capital or hoarding of goods, but might well interfere with the productive investment programme as it reduces the cash value of industrial reserves held in the form of Government obligations, and as it makes capital issues difficult.

If indeed only such investment were pruned as would free productive capacity for exports without compromising our need to increase productivity (e.g. investment in buses and other transport vehicles), if expenditure of defence were cut, leading to a fall in disbursements abroad or to a decrease in the purchase of oil or armaments, the argument that 'disinflation' can secure 'equilibrium' without discriminating controls *and* without causing unnecessary hardship would gain in value. But a cut in, for example, food subsidies and a rise in prices would—even if wages did not increase sympathetically—reduce, not indeed expenditure on necessities, but mainly marginal outlay on amusements, etc. The help to the export drive or import saving would be negligible.<sup>1</sup> The fall in national income would have to be a multiple of the effect desired and this would involve mass unemployment. If the overall deficit in the balance of payments is estimated at about £150 million and the need to cover capital exports, offset dissaving etc., say, between £150–200 million, total outlay at home would have to be cut not by £300–350 million but more likely by at least £600–800 million.

A much more discriminating policy is needed if the orthodox 'cure' of deflation leading to mass-unemployment is to be avoided: if such policy is adopted then the extent of the monetary readjustment is not serious, because any excess purchasing power can then be deflected towards innocuous uses and the rise in production can be enforced by stimulating efficient firms through priority allocations by standardization and other measures discussed below.<sup>2</sup>

The decontrol of the prices of non-utility goods, the relaxation of production controls, will, however, render the policy of price-stabilization difficult. The Government—despite its raising the price of bread and flour, of metals, and permitting an early rise in petrol prices—insists that the price of goods already finished and those unfinished goods, the raw materials for which have already been

<sup>1</sup> Cf. Chapter 2 on the experience of 1947–8.

<sup>2</sup> Cf. Appendix III, pp. 238–50.

purchased, should not be increased. It is doubtful whether, in fact, this policy can succeed in practice as price control on many goods has already been discontinued and some further categories are to be decontrolled in the next few months. The pull of export prices will unquestionably deplete supplies at home. The attempt to decrease the prices of utility goods will, under these circumstances, further disorganize production.<sup>1</sup> Moreover, many traders, knowing that prices are to be increased, will withhold sales. In view of the continued process of decontrol, the Government has little power to enforce its policy. A sharp increase of the bank rate might do it, but in view of the proportions of devaluation which will eventually result (unless the American slump supervenes) in an increase of between 15 and 25 per cent in the price of raw materials determined by the American market irrespective of whether they come from the dollar area or not, it would take a very harsh deflation to make any appreciable effect. The policy of differential (low) prices for the home market, an obviously sound one in existing British conditions, seems impracticable if controls are not reinforced.

Once more we are thrown back to the conclusion that the Government's experts have not completely thought out the difficulties inherent in an economic system in which crude deflationary readjustment, the main weapon of a free economy, is ruled out politically, and where direct controls have been discontinued or fatally weakened or are administered in a half-hearted manner. Investigations into the distribution of the national income show quite clearly that prices could be kept all but stable—despite the rise in costs—if profit margins could be reduced.<sup>2</sup> But without reforms the Government will be as unsuccessful in preventing a rise in prices, and eventually of wages, as it was in trying to cut export prices before devaluation. The choice between deflation and controls will be posed again, and it is to be feared that expert opinion will once more press for the former because it eases the administrative task and lessens direct responsibility.<sup>3</sup>

<sup>1</sup> *Ibid*

<sup>2</sup> It will in any case be interesting to observe how a proportionate rise in the price of the finished product (instead of merely adding the rise in the price of the raw materials) can be avoided if controls are not stiffened.

<sup>3</sup> This is to some extent the explanation of the reluctance of the officials to develop and to use statistics throwing light on the real causes of the crisis (cf. the reported 'disowning' by the Central Statistical Office of calculations made by E.C.E.—based on British official statistics. *The Economist*, October 1, 1949, p. 717). Nothing characterizes this attitude better than the

In the end the rise in import costs will be mainly, if not entirely, determined by the state of the U.S. market. Should the present unsatisfactory but not yet serious position continue in the U.S., and *in the absence of a determined effort in this country to reduce profit margins*, the rise in the internal price level might be of the order or magnitude of between 4-7 per cent.<sup>1</sup> The voluntary restraint of trade unions was already tried hard as the result of the increase in the price of necessities due to the discontinuation of some and the limitation of other subsidies. The rigid continuation of wage-stabilization will, therefore, hardly be practicable. Unless the Government contemplates a reform of controls, it might be better, therefore, to come to some estimate of the increase in total incomes which would not be detrimental to the international balance. From a purely commercial point of view, i.e. excluding Government expenditure abroad as well as release of sterling balances and capital flight, the pound is substantially undervalued. If therefore proper controls are applied on capital movements, some concessions to the lower paid workers and old age pensioners, and to large families, should be possible. It would be salutary to promote general understanding of these difficult problems if the distribution of the increase were left to a representative body of the Trade Unions. They should take responsibility and evolve a coherent wage policy.

If the gap due to the elimination of the overall deficit, and the increase of exports to compensate the fall in U.S. aid and to carry capital exports, is put at, say, £300-450 million (and a rise in British domestic prices is prevented), £200-300 million of the total could be found within a short period through an increase in production if immediate and energetic steps are taken. A 10-15 per cent

statement in the recent Economic Survey for 1949 (Cmd 7647, §109, p. 40) that 'when wages movements are under some voluntary restraint, they provide somewhat uncertain evidence about the inflationary situation' So long as full employment obtains, on the contrary, a threat of true inflation cannot arise so long as wage demands are not pressed beyond those justified by an increase in productivity. The wording of the Survey seems to indicate that its authors seem to find in *an increase of unemployment* only the proof or guarantee of the cessation of inflation.

<sup>1</sup> A violent fall in U.S. prices would raise other even more intractable problems. Apart from an increase in the price of imports from areas which have not devalued or have not devalued as much as Britain, the sterling prices of primary products for which the United States are an important market, but which Britain imports, will tend to rise, exactly as sterling export prices will rise. In their case the same dilemma arises as with respect to British prices. From the point of view of the dollar gap the greatest possible increase is to be desired. But this rise will worsen the British terms of trade with primary producing countries and thus depress the British standard of life—though it will help some even poorer countries, and eventually increase sterling supplies.

increase in productivity—which is well within grasp—would yield approximately £600–800 million of additional output. In the meantime a discriminating cut in outlay might supply most of the rest. There obviously exist a large field in which retrenchment is desirable *in itself* and not merely because of its ‘disinflationary’ effects. Pruning of home outlay is therefore possible. But we must bear in mind that only a cut of expenditure which results in outlay abroad, or which frees export capacity capable of producing for export (including manpower which can be re-employed in undermanned export industries), will be effective and not merely result in unnecessary hardship including unemployment. Provided, therefore, that discrimination is used through raw material allocations, limitation of supplies to the home market, etc., the necessary increase in export supplies can be accomplished without a multiple cut of home outlay. Temporarily, until industrial reorganization has produced its effects, the home consumption of some essential products might have to be curtailed (e.g. textiles) because export markets exist the immediate conquest of which is essential. Such temporary cut, however, should be tolerable if equity is maintained, i.e. if rationing by needs rather than by the purse is reintroduced. The excess of purchasing power will then, once more, be deflected towards innocuous outlets. The basic investment programme must not be cut in view of the darkening economic horizon. So long as a wage-spiral can be avoided, and the control of the production and distribution of necessities should effect this, a cumulative inflation need not be feared. A rise of the price of some luxuries or fuller use of entertainment and other innocuous outlets for spending is then of no consequence.

If the internal implications of devaluation seem imperfectly understood equal dangers apparently threaten on the international field. The failure of British (and European) exports to the U.S. to expand was not mainly due to high prices.<sup>1</sup> Risk and the need of preliminary huge investment in advertising and merchandising played a more important rôle. It is to be feared that under misguided and not even always sincere American guidance greater sacrifice will be made to capture the U.S. market than is economically justifiable. Export boosting financed by the Government or compulsory levies is not limited by normal commercial considerations.

<sup>1</sup> Cf. Chapters 4 and 6. Cf. above on the influence of excessive profit margins.



Up to a point this is an advantage, and should be used to clear away obstacles which single firms are too weak to remove. It would be fatal, however, never to count the cost, and ideas have been mooted recently which, however justified they might have been to avoid devaluation, would be quite improper now. Both on account of instability and the likelihood of energetic steps against manufactured imports, a sense of proportion ought to be retained in our policy of pushing direct exports into the U.S. This does not exclude a considerable increase in the volume of exports to U.S. (after all, a 20-25 per cent increase is called for if the dollar value of our exports is to be retained), but merely suggests that an indirect approach to the solution of the dollar problem should be pursued with *equal* energy. It is in any case likely that much the greater part of the readjustment in the direct dollar balance will have to come from a cut in dollar imports, thus by a measure which could have been put into operation without the losses caused by devaluation had co-operation with the non-dollar area been less imperfect.

If U.S. exports could be supplanted in third markets by the price differential caused by the devaluation, and provided that this is followed up *with the judicious use of controls* by the sterling area and other 'soft' or 'less hard' areas, much more stable gains could accrue to the non-dollar balance of payments. The damming of the flood of British funds to the sterling area which might be used to finance unrequited exports, together with energetic measures to push exports, should once more restore the sterling area dollar balance.

There has been no indication, however, that the present policy of the Bank of England, which fails in preventing the flow of capital into the Empire, and thus permits the finance of unrequited exports, will be reversed. Nor is there any reason to believe that the rise in sterling export prices consequent on devaluation will lead to a drying up of the demand for such exports. For political and military reasons the release of old sterling balances was not merely not diminished but stepped up, and the capital flight will continue in the longer run. Unless the policy of the exchange control is changed, the diversion of exports will not succeed. Devaluation is not an alternative to the tightening of exchange control and to the co-ordination of economic and monetary policy in the Commonwealth, if the recurrence of the troubles of the recent past is to be avoided.

In this context it might be mentioned that insufficient steps were taken to maintain the dollar price of certain sterling area exports. Rubber and cocoa are the main examples. Both suffered an unwarranted decline in value in terms of dollars, a decline which will not be offset by a stable increase of demand unless U.S. business revives. It is regrettable that more definite commitments could not be obtained in this respect from the U.S.

Nor are the other points of the Washington communique more reassuring. The permission to use E.R.P. funds for Canadian purchases is obviously of transient importance only. The modification of U.S. tariffs and customs procedure could go some way in solving the medium-run dollar problem though they could not prevent a recurrence of the crisis if U.S. productivity continued to increase at a higher rate than the European and British<sup>1</sup> unless a series of unilateral concessions is contemplated. This, to say the least, is highly unlikely. And even the value of the immediately practicable concessions should not be overestimated.<sup>2</sup> Unless U.S. domestic policy undergoes profound alteration and demand is kept slightly above internal supply continuously over a long period the resistance experienced will be insuperable by any economically justifiable means. After all there is no reason for us to give away our labour for little return.

In the longer run American private investment abroad and attempts by Britain and Europe to increase productivity are to be relied on to solve the dollar gap. Both seem insufficient from this point of view. The discrepancy between the American investment capacity and immediately highly profitable outlets elsewhere is exceedingly great.<sup>3</sup> The plans submitted to the American administration of British colonial developments, totalling £400 million, demonstrate this sufficiently. Nor must it be forgotten that, despite the fact that the British colonies represent probably one of the most promising areas of the world from this point of view, the *total* plans drawn up amount to less than 5 per cent of the *yearly* rate of American capital investment. American private investment on a sufficient scale would clearly represent a complete alienation of the productive structure of these territories to American ownership. Nor should the political implications of such a plan be forgotten. The private

<sup>1</sup> Cf. Chapter 1 and Appendix II.

<sup>2</sup> The increase in the demand for natural rubber is estimated at 50,000 tons

<sup>3</sup> Cf. Chapters 1 and 4, esp. pp. 88-9

investor, as we have been told quite brutally by the spokesmen of the more conservative wing of the American administration, demands adequate returns and adequate security. The combination of the two in plain words implies substantial exploitation by vigorous capitalist organizations of native populations, the policing of which is left to Britain. Is this a possible solution of Western troubles? Is Britain to carry the moral and material burden and the U.S. entrepreneur to reap the profits?—or diminish the attractiveness of Communism in areas vital economically and strategically?

There is as yet no realization in the U.S. that her present position, which is the direct outcome of the war, tends to create a dollar shortage and that orthodox measures will in all likelihood aggravate the problem even if they can deal with it temporarily, which is somewhat doubtful. The reduction of the total of Marshall Aid shows that the inter-relations of domestic and foreign economic policy continue to be disregarded. The arms-subsidy voted for Europe will not be sufficient to redress the unbalance caused by the U.S. recession. Even if we take account of Marshall Aid on both sides the U.K. and the U.S. spend roughly the same proportion (about 8 per cent) of their national income on defence and related political obligations,<sup>1</sup> despite the fact that the national income in the U.S. was roughly double that of the U.K. The shouldering of this unduly large share of the defence expenditure by Britain further intensifies the dollar problem of this country. No effective relief has been obtained in Washington, though for the first time the importance of the stability of the sterling area was recognized and complete political agreement was said to have been reached.

Nor is it clear how Europe is to approach the U.S. level of productivity and thus tackle the basic cause of the unbalance. The wave of strikes in the U.S. might be of some temporary assistance to European exports. The unexpected strength of the U.S. Trade Unions enforcing increases in labour costs should have a longer lasting effect on relative competitiveness and thus tend to postpone the re-emergence of pressure. On the other hand, no plans have been drawn up to increase the complementarity of European economies. Indeed, all signs point to increased intra-European competitiveness; and a competitiveness increased by deflation and unemployment in the *laissez-faire* countries.

<sup>1</sup> In which the unrequested exports to India, etc., must be included

In view of the magnitude of the readjustment, and the failure to devise new policies, the present dose of reducing the standard of life in Europe by devaluation must be considered as insufficient to close the *final* dollar gap after 1952, though it might close the *current* dollar gap while Marshall Aid is still available, provided the U.S. recession does not continue. The new parities must therefore be regarded as temporary unless a solution can be found to deal with the basic problem of the relative American and European productivity and sales power, which has not been provided by the Washington Agreement.

If, moreover, internal and external controls in the sterling area are not reinforced, if the Board of Trade, the Treasury, and the Bank of England are not reorganized, the Government will either have to capitulate to the orthodox deflationary demands of the Conservatives or face a new attack on the pound. The progressive course in Britain and Western Europe stands and falls with its capacity to increase production and provide an increasingly just distribution of income. The inter-war period has given ample proof that neither is obtainable in Europe by relying on the free market mechanism. The experience of the post-war development on the Continent has confirmed this conclusion. The productive achievement of Britain in the last few years, far surpassing anything in the last fifty years, has also shown up for what they are worth the hypocritical demands for 'stronger incentives' for the rich in the shape of higher net incomes by those who argue that a similar stimulus to the poor could only be imparted by a cut in their real income. A policy, such as general deflation, however, which discourages investment frustrates the first aim (*pace* the Liberal 'experts' who in this respect are oblivious even of their own theories). Devaluation, which endangers the second, can only serve constructive ends if it was treated as a *recul pour mieux sauter*; as a breathing space to adopt policies which would have made it unnecessary.

## WESTERN EUROPEAN CO-OPERATION

The conclusion reached in the main part of this essay<sup>1</sup> that a satisfactory solution of Western economic problems depends on the international development of the poorer, financed out of *free* contri-

<sup>1</sup> Chapter 6

butions of the richer, countries has lost nothing in urgency by the measures envisaged at Washington. Nor has the establishment of a more complementary economic system in Western Europe diminished in importance. After all, what we have witnessed is a very minor affair due to slight cyclical causes. What will happen if Marshall Aid is in fact discontinued, without a stable and wider scheme taking its part, in a period of flagging fixed investment in the U.S., and an acute deflationary wave in a more or less reconstructed Germany and Japan, I prefer to leave to the imagination of the reader.

Unfortunately the Government was so overwhelmed by the immediate problem that they paid little attention to the much graver, albeit somewhat more—but not too—distant, contingencies. In one of the subsequent chapters<sup>1</sup> the problem of a closer European co-operation is discussed at some length and the conclusion is reached that a forced short cut either to an economic or monetary union is wholly premature and would probably involve the more industrialized countries in a serious deterioration of their economic position and thus to a disintegration of the union. The cautious approach of the British Government to federalist or similar plans was therefore commendable. It is also argued, however, that much more energetic and far-reaching measures are needed and are practicable than have been envisaged by O.E.E.C.

A scheme of combining the co-ordination of investment with appropriate compensation should be worked out immediately.<sup>2</sup> Nor could strictly intra-European preferential agreements solve the problem of Europe. In order to build up slowly a viable system, temporary preferential treatment of European goods in *third* markets is required which are complementary and not competitive in character. The devaluation of most European currencies secures some of this advantage—unfortunately at the cost of a general deterioration of their terms of trade and on a very uncertain basis.

The events of the last few months have not contributed to the emergence either of a more reasonable frame of mind in the U.S. or of closer co-operation in Europe.

The plans of the E.C.A. to withhold a fund of \$150 million, to be allocated to the 'deserving,' together with the plan to permit a partial convertibility of the intra-European 'drawing-rights' looks

<sup>1</sup> Chapter 6, pp. 182-91

<sup>2</sup> Chapter 6.

suspiciously like an attempt to introduce convertibility without safeguards against cumulative deflation or similar beggar-my-neighbour policies. The proposal of the French Government to lift exchange-control within Europe and at the same time let the exchanges find their 'natural' level is equally courting cumulative monetary instability. As we have seen in the recent French crisis, devaluation in a *laissez-faire* economy must be coupled with deflation and unemployment if a wage-spiral is to be avoided. Such attempts must lead to further social disintegration and contrasts strangely with the earlier success of Sir Stafford Cripps in evolving, and securing U.S. approval to, a scheme of European payments which limited beggar-my-neighbour policies in the rest of Europe.

The occasion presented by the first meeting of the Council of Europe could have been used to make known the principles of the British Government's economic and social policy. A full employment of productive resources and an increasing equality in the fruits of labour are tasks which seem to have been forgotten in the welter of abstract nouns behind which the opponents of progress shelter. In a period of growing social inequality and unemployment in Europe it could have regained some prestige for Britain and paved the way for a reversal of the insensate policy now pursued in most countries. While refusing to be terrorized by a majority into a reversal of its aims, the British delegation could have put forward practical proposals to mitigate the appalling inequality of opportunity within Europe on which—above all, and beyond political differences—the more high-falutin proposals for unions, federal or otherwise, must break. Functional co-ordination and intra-European compensation schemes, positive proposals forcing the opponents of rational economic policy into the open might have restored Britain's lost initiative.

This opportunity was lost. The background was already spoilt by the extraordinary tergiversation on the question of allocating Marshall Aid at the O.E.E.C. meeting in Paris. Having rather unnecessarily cut its request for aid by 25 per cent last year, the British Government suddenly increased it by almost 25 per cent to about 30 per cent of the total. The deflationary policy in Belgium and the consequent loss of gold to that country justified some increase in the British share. But it was impolitic to try in the last moment to cover the deficit of the whole sterling area through the

*European Recovery Programme*. The resulting deadlock was only broken by handing over the decision on distribution to the Chairman and Secretary, i.e. giving them power which the previous British policy sought to deny them. In this instance superficial and mistaken appreciation of the position by the Government's experts was clearly in evidence. A stronger secretariat, adequately manned, would have helped rather than hindered British interests. The arbitration yielded far better results than the negotiations conducted by the British representatives. The British share was increased from \$850 million to \$962 million, i.e. somewhat above the original request of the Government.<sup>1</sup>

But the suspicions of the Continental countries were aroused. And when the Council met, a determined and skilled effort would have been needed to turn the tables on the *laissez faire* attacks. In point of fact no preparation had been made and no policy worked out and co-ordinated with Continental sympathizers. The admission of Turkey and Greece on a very questionable political basis<sup>2</sup>—they can hardly be called democratic at this stage—by the ministerial committee, made any concessions on economic and social matters even less advisable and strengthened the opposition to British policy. Thus a negative attitude was forced on the Labour representatives and, apart from Mr. Morrison's tactical skill in warding off over-enthusiastic and potentially embarrassing proposals, the initiative was rapidly taken by the other side. The impression was successfully spread in Europe and America that the British Government wishes to impede *all* collaboration in Europe and not only *such* superficial 'unification' as would spread unemployment and misery to this country. A more unfortunate outcome could hardly be imagined, as it must further weaken those in Western Europe who would collaborate with a progressive Britain.<sup>3</sup>

The brusque announcement of devaluation and the turmoil into which a number of countries were plunged on the Continent, and the consequences of which are not yet clear, will further weaken British claims to leadership. Once a system of parities is upset,

<sup>1</sup> The 'net' aid received is a slightly bigger proportion as the drawing right granted by U K has been reduced to \$69 million. All these agreements have been thrown into the melting pot as a result of devaluation.

<sup>2</sup> Quite apart from the fact that it must have increased Soviet suspicions. Cf. below, p. 57.

<sup>3</sup> Just as Mr. Bevin's unfortunately phrased attack on Germany a few days before the German elections further undermined the position of the Social-Democrats, while not acting as a deterrent against the extreme nationalists.

however justifiable the first move may be *per se*, the repercussions are bound to be painful and might in the end react unfavourably against the initiating country. By 1936 most of the competitive gains reaped by this country in 1931 by depreciating sterling were lost and in 1938 it was once more under heavy pressure. It is true that most of those countries which now complain because they have not been consulted, were busily engaged in attacking sterling. It is also true that lengthy negotiations involving many people increase the danger of indiscretions. Nor can there be much doubt that the black market in sterling would have continued on the Continent if devaluation had been less drastic and with it the drain on the dollar resources of the Commonwealth. Nevertheless, if Britain is to play a leading rôle in Europe—and her economic position will be exceedingly weak unless she succeeds in doing so—some calculated risks must be taken. At any rate, the willingness to collaborate in reducing the unfavourable consequences of the devaluation of sterling should be stressed and the responsibility accepted without taking undue risks.<sup>1</sup> The dangerous impression has been created that Britain prefers to deal bilaterally with the U.S. in framing British policy. This stimulates emulation and leaves Western Europe and this country at a disadvantage in its negotiations with the U.S. However difficult it may be to restore European solidarity, a new effort certainly should be made.

The survival of Western European social system depends on the evolution of a new approach to the problem of international and national inequality. If a progressively improving and progressively juster economic and social system can be established in the West, and the material conditions for such a solution exist, it can confidently leave Communism to wallow in its suspicions and abuse its, terror and enforced confessions, without any fear of internal decomposition.

<sup>1</sup> Recent British policy seems to court risks without securing either approbation or collaboration. In view of the disturbing proposals emanating from Continental Governments to abandon fixed currency parities, which, in a generally deflationary position, might have serious consequences on the balance of trade of this country with the Continental Western countries, the unilateral freeing of a wide category of imports into Britain seems somewhat rash. It would have been preferable to press for a general conference on economic and monetary policy at O.E.E.C. and try to initiate a closer co-ordination of investment between the countries concerned. The trend towards Continental compacts, much strengthened by the unavoidable sharpness of the British devaluation and the failure to initiate conversations immediately afterwards, might have extremely unfavourable results to this country (cf. the critique of the British Four-Year Programme, Chapters 4 and 6).



Inevitably, then, the attitude of the United States will be decisive and every effort must be made to obtain her collaboration in a solution of an expansive character. President Truman's actions show that there is a good chance of obtaining it, though the approach of Congressional elections is a retarding factor. It is obvious, however, that the British Government must adopt a more active attitude and put forward concrete proposals if an early solution of the Western problems is to be achieved. The twin problems of stability and steady development must be solved if we are to avoid a recrudescence of the Communist menace and, eventually, an armed conflict. It would be especially important to create permanent international institutions capable of exerting an expansionist bias on the Western World without bilateral dependence on the U.S. and the need for *ad hoc* appropriations. Economically the prolonged process of yearly debates on, and threats to, the foundations of Western recovery is profoundly unsatisfactory. Politically, the reliance on recurrent tension with Russia for obtaining Congressional approval for recovery and aid measures can only end disastrously. The circumstances in which the Marshall Aid and arms appropriation were passed underline the vital need for a more permanent solution, possible variants of which have been outlined in the last chapter of this essay.

If American collaboration cannot be obtained, measures to strengthen the economic independence from dollar supplies will have to be intensified before a new crisis is upon us.<sup>1</sup> Accordingly, British military and quasi-military commitments, e.g. the release of sterling balances to the Middle East, will have to be reconsidered just as aid to Greece had to be reconsidered in 1947. Reciprocal trade pacts will have to be strengthened and the commercial policy and exchange controls of the Commonwealth reorganized. As time passes supplies from these areas should increase and the potential loss of real income due to the restriction of international intercourse mitigated. The fall in demand for 'hard' currency exports and the consequent deflationary tendency might make the countries outside the Commonwealth (and, possibly, Western Europe) more willing to establish common agencies to ensure stable economic expansion.

<sup>1</sup> In particular it must be made clear to Canada that the maintenance of her dollar gap is not a prescriptive right. The maintenance of British purchases will inevitably involve payment in sterling and an increase of Canadian purchases in Britain.

There can be little doubt, however, that Britain will only be able to secure the adoption of a programme in line with the Government's domestic policy if that policy is visibly successful in mastering her own economic difficulties. A reorganization of her financial and industrial administration and the consequent change in policies can no longer be postponed. The issue between crude deflationary policies, based on the rejection of the possibility of rational collaboration of different classes in the community, and the conscious planning of the full use of the resources available, which has not been faced prior to the devaluation, and has yet again been postponed, will have to be decided. The success of the British productive effort shows the potentialities of a programme of industrial reorganization. Even in 1949 an advance of almost 5 per cent has been achieved over last year. Far greater progress could be made, and would be decisive in winning support abroad for a co-operative effort to mitigate national and international inequalities. It is on the success of this effort that the survival of Western Europe as a centre of industry and urban culture will in the end depend.<sup>1</sup>

<sup>1</sup> The Government statement on domestic economic policy consequent on devaluation was made when this essay was being printed. It represents a decisive though only negative defeat of the crude deflationist school, which hopes for 'readjustment' through decontrol, through an open retreat from the 'welfare state' and through an increase of unemployment. The cut in outlay through increased taxation and reduced investment and Government expenditure of some £250 million is, as we have shown above, hardly enough to fill the 'gap,' unless productivity is increased decisively, the incubus of capital exports and sterling balance releases is not brought under control, foreign commitments limited, and last but not least, unless the position in the U.S. and elsewhere does not take a turn to the worse. Apart from the contemplated saving of £30 million p.a. on defence, the character of which has not yet been disclosed, and from the direct cut in imports from the U.S. earlier decided upon, most of the cuts represent an indirect approach to the readjustment of the foreign balance. *The vital importance of reforming, reinforcing, and extending controls, therefore, is further underlined.* The aims of the retrenchment would otherwise be frustrated.

It is quite clear, however, that the struggle between the two approaches to the solution of the British, indeed Western, economic problem, between deflation and balanced control, has still to be resolved *in a positive sense*. It is insufficient merely to reject deflation. A positive policy is needed and has yet to be devised and accepted. The urge towards decontrol persists and has yet to be defeated. Special horror is expressed of rationing with no realization of the implications of the alternative. Nor can much more time be wasted. The Government's measures will further accentuate the tendency due to devaluation towards a disproportionate increase in the cost of living of the poor, and with it the likelihood of wage demands as well as of demands for the revision of the scale of family allowances and social benefit payments. The policy of differential, low, prices for the home market cannot be carried out without a change in administrative methods. Shop shortages and hidden price increases will otherwise defeat the Government's policy. The increase of productivity cannot be hoped for without effective price control, reinforced by priority allocations of raw materials, enforced standardization, and other production controls. Nor can the windfall profits of industries, which cannot expand their foreign sales profitably, be utilized for an energetic all-round campaign of export promotion unless, at long last, Development Councils are generally organized and

linked in an Export Pool. If the present opportunity is wasted and the recasting of industrial (including wages) and foreign exchange policy is once more postponed, further crises can hardly be avoided. Domestically the Government has yet to regain the initiative.

Finally, it is still not recognized that British policy alone can no longer devise once-for-all solutions to the dollar problem. The deficit of Britain and Western Europe is merely the obverse of the continued export surplus of America, and without American contribution any policy which Europe may devise is temporary and subject to the further developments in the dominant economy of the West, the United States. Policies, moreover, which might contribute to the balancing of the international account of Britain, but increase the difficulties of the rest of Western Europe (or the reverse), must be condemned in the same way as American policies increasing the dollar shortage must be criticized. It is greatly regrettable that the dominant country has not come nearer to appreciating the basic problems facing the non-Communist world.



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# THE DOLLAR CRISIS

## CHAPTER I

### THE BACKGROUND OF THE ECONOMIC CRISIS OF WESTERN EUROPE

THE second World War has finally smashed the delicate balance of the nineteenth-century world economy and undermined the fundamental basis of Western European existence. Yet it only brought to a violent climax tendencies which made themselves felt already at the closing stages of the last century, and were severely aggravated by the first World War, and, also, by the consequences of the Great Depression of 1929-34.

Nor can this problem be treated in isolation. It is but an aspect in the change of the relative position of Britain (and indeed of that of Europe which dominated all other continents politically and economically) in the general power equation of the world system as a whole. It is, perhaps, a moot question whether the decline of Britain could have been avoided in any event or arrested at any earlier stage. The economic paramountcy she had been able to achieve after the Napoleonic Wars was due to a combination of uniquely favourable circumstances. In view of the vast discrepancy of the basic economic, and, hence, power potential between the British Isles and the American or Eurasian continents, this seems unlikely once a single power succeeded in combining either of those potentials, or even a considerable part of them, in an effective system. But had the process of change been slower, it is possible that public opinion in the British Commonwealth, and perhaps other countries, might have acquired the foresight and determination necessary to deal with the problems facing oceanic and national systems when confronted with Continental empires.

There can be no doubt in any case that the two wars enormously accelerated the inherent trend and made readjustments accordingly difficult to accomplish. Their effect was, moreover, to weaken, and in a certain sense to exhaust completely, those reserves of foreign assets which, accumulated in an earlier and more fortunate period, could have been used to furnish a basis for a difficult transition. The

quickening of technical progress outside Europe, and more especially the development of new methods of mass production, represents an additional complication. It diminishes the relative advantages which can be enjoyed by smaller economic areas even in the best possible circumstances. This must increase the difficulty of the readjustment and might render it impracticable by traditional means.

### THE EUROPEAN BALANCE OF PAYMENTS

The precariousness of the economic position of Europe can best be illustrated by a comparison of its balance of payments in 1938 and 1948.

TABLE I

EUROPE'S BALANCE OF PAYMENTS<sup>1</sup>

Thousand millions of dollars in current prices

	1938			1947		
	United States	Other non-European countries	Total	United States	Other non-European countries	Total
Europe's imports (f.o.b.) .. ..	1.3	4.2	5.5	6.1	7.8	13.9
Europe's exports (f.o.b.) .. ..	0.6	3.1	3.7	0.9	5.5	6.4
Balance on trade account .. ..	-0.7	-1.1	-1.8	-5.2	-2.3	-7.5
Income from investment (net) ..	+0.1	+1.1	+1.2	—	+0.6	+0.6
Transportation (net)	+0.2	+0.4	+0.6	-0.7	+0.3	-0.4
Other invisibles (net)				+0.2	-0.5	-0.3
Balance on invisibles account . . .	+0.3	+1.5	+1.8	-0.5	+0.4	-0.1
Balance on goods and services .. .	-0.4	+0.4	—	-5.7	-1.9	-7.6

<sup>1</sup> United Nations, Department of Economic Affairs, Economic Commission for Europe. *Economic Survey of Europe* in 1948, Geneva, 1949, p. 112, Table 71. For sources of the Report. In the following this Report is quoted as E.C.E., 1949 Report. The first of its reports, *A Survey of the Economic Situation and Prospects of Europe*, Geneva, 1948, will be quoted as the E.C.E., 1948 Report.

The balance of the last pre-war year became a deficit of \$7,500

million (or £1,875 million), despite the fact that total imports were almost a fifth below the pre-war volume. Four important factors were responsible for this catastrophic deterioration, the brunt of which fell on Britain:

1. Foreign invisible income which amounted to \$2.100 million p.a. disappeared and on balance Europe became a debtor to the tune of \$600 million p.a.
2. There was a sharp decline in production, especially agricultural production, which resulted in a decline in exports while imports had to be maintained in order to permit the maintenance of a tolerable standard of life.
3. The terms at which Europe could obtain primary products, food and raw materials in exchange for her own mainly manufactured exports became considerably less favourable.<sup>1</sup>
4. The worsening of the visible trade balance amounted to \$4,800 million. To a large extent this was due to an approximate doubling of the price-level (the import surplus was \$2,100 million in 1938). Had prices remained unchanged the unfavourable balance would have been reduced to \$3,300.

The pattern of Western European trade was, in addition, very seriously upset by the division of Europe into two parts, between which commercial relations shrank very seriously. Even if we leave out of account the break-up of the unity of Germany, and the loss by the west of agricultural supplies from the Eastern territories,<sup>2</sup> there has been an almost catastrophic fall in trade.

It is seen that European imports did not increase above the pre-war level. The appalling deficit was caused by the shrinkage of exports. The even greater relative deterioration of the balance with the Western Hemisphere was the result of the fall in supplies from Eastern Europe, Asia and Africa, and the diversion of supplies from the Pacific to Asia. These could only be obtained in North America.

<sup>1</sup> More accurately the deterioration of Britain's terms of trade was much more significant than the slight improvement of those of Continental countries, the volume of whose foreign trade contracted. By 1948 most countries' terms of trade were slightly worse than in 1938. In the trade with overseas countries the terms of trade of the U.K. (1938=100) were 117 and 116 in 1947 and 1948. The terms of trade of other European countries had worsened in these years from 89 to 104. E.C.E., 1949 *Report*, p. 99, Table 64. Cf. below, however, on the effects of the increase in North American agricultural supplies.

<sup>2</sup> Trade before the war between Eastern and Western Germany was estimated at \$1,000 million p.a. E.C.E., 1949 *Report*, p. 156. In 1947 it was only about R.M. 600 million, or, at pre-war prices, not much above \$50 million; in 1948, after some recovery, it came to a virtual end as a result of Allied counter-measures consequent on the Berlin blockade.

The fall in production (especially in Germany) and in foreign income (especially in Britain), however, was sufficiently serious to

TABLE II  
O.E.E.C. COUNTRIES' TRADE

<i>Volume of imports in 1947 (1938=100)</i>			<i>Imports ('000 m. dollars at 1948-9 prices)</i>		
				1938	1947
Imports .. ..	96		North and Central America ..	4.1	7.3
Financed by			South America . . .	1.7	1.7
exports ..	41		Non-participating sterling area	2.9	2.0
invisibles ..	6		Eastern Europe . . .	3.0	0.9
reserves, loans,			Other countries .. ..	1.3	0.6
gifts, etc. ..	61				
Exports .. ..	68			13.0	12.5

cut the volume of resources available to Western Europe by some 15 per cent, despite the fall in exports, and the consequent increase in the deficit of the balance of payments. As population increased, if only slightly, the commodities available per head show a somewhat greater fall. The increase in the import of bread-grains by the O.E.E.C. countries was 50 per cent; and of solid fuels nearly 170 per cent. Together with timber, fats and oils, meat and petroleum these account for \$2,000 million of the total increase of imports of \$3,250 million from North America.

The task of European reconstruction in the face of this deterioration of her international position was twofold, if a very serious decline in the standard of living was to be avoided,

- (a) to secure a restoration of the balance of production and thus an increase in productivity and output;
- (b) to secure markets for a sufficient part of this increased output to pay for the imports required *after* the increase in home production, i.e. after the need for emergency imports due to the decline in European production has passed.

Both tasks presented formidable difficulties. The increase in production was itself dependent on increased investment to repair the war-damage and to eliminate acute bottlenecks. But after six years of war and hardship it was difficult to ask the population to forgo part of the decreased supplies in order to restore the productive structure. 'Austerity' was under attack in most countries in 1946-7,

and 'controls' needed to ensure equality of sacrifice were no less so. Yet, in the absence of foreign aid, investment was entirely dependent on a repression of consumption. And it was impossible to cut the consumption of the poorer classes without inflicting serious hardship. Without effective direct taxation, rationing and price-control, however, consumption could only be kept low by increasing the inequality of the distribution of income which had to result in precisely that consequence. Nevertheless, the political pressure in favour of restoring 'freedom' steadily gained ground in Europe.

### f. THE SHIFT IN THE BALANCE OF WORLD ECONOMIC POWER

The whole economic problem was exceedingly complicated by the emergence of the United States as an overwhelmingly dominant power, and the hostility between the West and the Soviet Bloc. The former reduces the chances of the restoration of a smoothly-working international economy. The latter makes it difficult to search for an alternative solution in intensified trading with the East which, unlike the United States, is economically complementary to Western Europe.

Some 50 per cent of the world's effective monetary demand and perhaps as much as three-quarters of total investment capacity outside the Soviet orbit, i.e. the capacity to invest without causing inflation at full employment, has been concentrated in the United States.<sup>1-2</sup>

<sup>1</sup> Cf my paper, 'The U S and International Economic Equilibrium' in *Foreign Economic Policy for the U S*, ed S. Harris, Harvard, 1948

<sup>2</sup> The rise of the U S to its present position is illustrated by the following table.

Period	MANUFACTURING CAPACITY <sup>1</sup>				
	U S	U K World=100	Germany	France	Russia (U S S R.)
1870	23.5	31.8	13.2	10.3	3.7
1881-5	28.6	26.6	13.9	8.6	3.4
1896-1900	30.1	19.5	16.6	7.1	5.0
1906-10	35.5	14.7	15.9	6.4	5.0
1913	35.8	14.0	15.7	6.4	5.5
1926-9	42.2	9.4	11.6	6.6	4.3
1936-8	32.2	9.2	10.7	4.5	18.5

  

NET VALUE OF INDUSTRIAL COMMODITY PRODUCTION <sup>2</sup>					
Millions of \$ in 1938 prices					
	U S	U K	Germany	France	Total Europe excl U S S R.
1938	21.500	6.696	9.066	3.155	28.243
1947..	35.500	7.232	3.107	2.997	22.958
1948	36.550	8.102	4.129	3.407	26.317

<sup>1</sup> League of Nations, *Industrialization and Foreign Trade* <sup>2</sup> B C E, 1949 Report, Table 16, p. 21.

No comment is required.

It could and should have been foreseen that, first, the maintenance of economic stability would become even more difficult than it had proven already in the inter-war period. Secondly, the discrepancy between the size and wealth of the United States and any other single country has grown so enormously that producers in that country, *ceteris paribus*, acquired a considerable advantage.

As long as the world economy is organized on the basis of free multilateral markets, its stability depends primarily on the stability of its most important member, and the relationship of that country to the rest of the system. The latter will depend in its turn on factors such as the ratio of effective demand in that country to total world demand; on how imports and exports are affected by changes in the national income, as well as the relative intensity of demand for the leading countries' products<sup>1</sup>; and on the rate of investment and increase in productivity. It is quite possible that an increase in real income due to higher productivity will not increase demand for imports.

There can be no doubt that the rise of the U.S. and the impoverishment of the countries of Europe and Asia have created a very serious problem in this respect. The level of business activity in the U.S. could even less be influenced by outside factors than before, and very much less than that of Britain at the height of her economic influence.<sup>2</sup> A lending programme, at any rate, on any

<sup>1</sup> Cf. my paper, 'The Economics of International Readjustment' in the *Review of Economic Studies*, 1946-7.

<sup>2</sup> Cf. my paper 'The U.S. and the World Economy,' Oxford University Institute of Statistics *Bulletin*, October 1946. The following table illustrates the point:

NATIONAL INCOME, SAVINGS, AND FOREIGN TRADE				U.K. 1911	
U.S. 1948					
Estimated <sup>1</sup>		Actual annual rates <sup>2</sup>			
		IV quarter			
		in million \$			
Gross national income		180,000	235,000	Net income	1,988
Savings	personal	18,000	18,400	Depreciation, etc.	185
	corporate		12,900		
			31,300	Gross income	2,173
Imports (net)	5,500-6,300	7,700		Savings	414
Exports	7,000-14,000	11,800		Imports ..	577
Balance of Trade	+2,000-8,000	+6,700		Exports	454
Balance of inter-				Balance of Trade..	-123
national payments	+1,000-7,000	+7,800		Balance of international	
				payments	+194

<sup>1</sup> Mr E E Hagen of the Federal Reserve Board. <sup>2</sup> President's Midyear Report, op cit, 1949.

It is seen that savings were of the same order of magnitude in Britain as exports and imports. In the U.S. they far exceed them. The actual figures achieved in the U.S. were far less favourable to a smooth functioning of the balancing mechanism than Mr. Hagen's estimates, the use of which had been sharply criticized by the orthodox economists as too pessimistic.

scale which could be contemplated on commercial grounds alone, would—because of the relative poverty of other countries and the foreseeable difficulty of repayment—contribute little to the maintenance of stability in the United States. Stability in the world economy, therefore, could be expected to depend on the capacity of the United States to maintain activity by domestic measures and/or on arrangements of a non-commercial nature which would use U.S. productive power threatened with unemployment for the reconstruction or development of foreign countries.

It has become evident that the pre-war pattern of European multilateralism, which was based on massive export surpluses of Western Europe to Britain and depended for its viability on the convertibility of sterling, itself based on convertible surpluses to, and income from, overseas territories, cannot be restored without a conscious effort at planning on the international plane.

Apart from the specifically European dollar problem, the pattern of U.S. trade with non-European countries also changed and in the same manner: instead of an unfavourable visible balance of some \$100 million, on the average, in the inter-war period, she achieved an export surplus of \$1,600 million in 1946, \$4,500 million in 1947, and \$2,700 million in 1948. At the same time her average propensity to import declined from about 4·5 per cent prior to 1929 and 3·4 per cent over the whole of the inter-war period to 2·4 per cent in 1946-7. The consequent short-fall of U.S. imports has been estimated at no less than \$1,750 million in 1948.<sup>1</sup> The fall in imports from Europe was even more accentuated. This fall in Europe's relative share was partly the effect of the unavailability of supplies due either to the breakdown of production or to the intense demand elsewhere, and to the wartime interruption of trade which resulted in a change of consumers' habits which might in the longer run be modified. The prospect might therefore not be quite as bleak as these figures suggest. Nevertheless, even in this respect 'the automatism of the market' cannot be relied upon unaided to decrease the

<sup>1</sup> E.C.E. *Report*, p. 218. The so-called marginal propensity to import depends very much on the rate at which demand grows and the level of employment. A sudden increase in demand outstripping the increase in domestic supply would result in an increase of imports, while a slower one might not. Thus even a tolerably high level of employment in the U.S. might result in deflationary pressure abroad. These dynamic problems need much further investigation.

dollar gap.<sup>1</sup> The imperfections of the U.S. markets for manufactures are such that it would take time and effort to overcome them.

The second problem results from the fact that rapid development in the U.S. has rendered most industries in poorer and smaller countries obsolete. Insufficient attention has as yet been paid to the implications for the international competitive power of a country of its having achieved industrial supremacy, e.g. of the fact that it initiates new processes of production, creates new goods in which it obtains a monopoly position for at least some years. Moreover, the United States, based on a vast and well-protected domestic market, acquired advantages in industries in which mass-production methods can be applied, i.e. a growing number of the highest productivity industries.<sup>2</sup> The fact that the U.S. standard of living is so much higher than elsewhere strangely enough further supports its autarchy, as mass-markets are available for goods, which elsewhere cannot be sold in bulk. Hence the production costs are cut and export markets can be supplied at terms not manageable to other producers on the basis of a tolerable standard of life. Moreover, as a relatively underpopulated continental power the U.S. is amply blessed with natural resources. Her natural self-sufficiency is therefore very high. This has not only been strongly buttressed by tariffs and customs procedures but is also protected by common tastes and a system of education tending to promote conformity. Her wealth, moreover, enables her to provide a far larger proportion (and *a fortiori* absolute volume) of investment—as long as full employment is maintained.<sup>3</sup> Hence even if there were no deflation in the U.S., other countries might easily find their currencies periodically 'over-valued' as productivity would rise faster than elsewhere and wages and demand might not rise quickly enough. In any case it is not likely that her imports would increase sufficiently with rising income, or that foreign countries will not find themselves eliminated from the most productive lines of production; thus the difference between rich and poor

<sup>1</sup> The U.S. propensity to import rose in the first half of 1948 to almost 3·2 per cent. Unfortunately, the share of European exports in the total U.S. imports, which was 18·5 per cent before the war, fluctuates around 15 per cent since 1947 and shows no rising trend. This is explained by the fall of the share of manufactured articles, especially foodstuffs, in total imports.

<sup>2</sup> Cf. a more detailed analysis in *A Foreign Economic Policy for the U.S.*, op. cit., and also Appendix. 'The concept of a dollar shortage'

<sup>3</sup> This means monopoly advantage in new products and techniques and a decisive lead in technical progress. Cf. below, however, on the post-1946 developments



in the world, instead of being eliminated or diminished, would increase. If, on the other hand, deflation would supervene in the U.S., the impact on Western Europe would be even more disastrous.<sup>1</sup> Thus the dollar 'shortage' might well prove to be a recurrent phenomenon involving a continued deterioration of (at least the relative) standard of life of countries other than the U.S.

#### POPULATION MOVEMENT AND PRIMARY PRODUCTION

Two historically determined factors, in conjunction, contributed materially to the discomfiture of Europe. The first of these was the almost complete cessation of emigration from those countries which have a high reproduction rate and are industrially not well developed (conditions which usually coincide). The second was the delayed effect of the world agricultural crisis throughout the inter-war period, combined with damage to primary production due to the war. Neither is a short-term problem, and they are, therefore, exceedingly difficult to rectify.

The population of Europe (excluding Soviet Russia and Turkey) was roughly 385 million (on the basis of pre-war territories) in 1947, or some 9 million above 1939,<sup>2</sup> and almost 70 million above 1914. The population of the O.E.E.C. member countries has increased by 8 per cent since before the war, apart from the considerable westward movement of Germans from Eastern Europe. While Britain and France have probably experienced what might prove only a temporary sharp increase in their birthrate, the population of Italy, the least industrialized among the Western European member countries, shows an unchecked rapid expansion.

Prior to the war of 1914 the population pressure of Eastern Europe, and even from certain Western countries, was relieved by emigration. This has been almost completely dammed up. In the first decade of the century European emigration was well over a million. In the inter-war period it fell abruptly, and in the 1930s some European countries—including England—experienced a net immigration (even from overseas). This was accentuated after the Second War.

<sup>1</sup> The theoretical implications of this problem are discussed in an article on 'Static Models and International Economic Problems,' *Oxford Economic Papers*, New Series, No. 2, 1949.

<sup>2</sup> U.N.O. E.C.E., *Report 1948*, p. 27. Declines in population were restricted to Eastern Europe. They are accounted for by changes in territory and by the far higher civilian and military casualties.

Not only was the population pressure in Europe dammed back ever since the First War, but the balance between manufacture and agriculture also underwent a sharp change since the Second War. It is this change which is really at the root of the problem. Before the First War the nineteenth-century development of opening up new territories proceeded very fast. The relatively high prices of primary products, which caused some apprehension in Britain about an imminent population pressure, resulted in heavy overseas investment. Canada, Argentina and the Pacific Dominions (and to a lesser extent Africa) participated in this expansion. The flow of British overseas investment reached an all-time peak. This was followed by a further rapid expansion during the war, which interrupted Eastern European supplies. The inflationary boom after 1919 added its quota to the expansion.

After the First War, therefore, the world was confronted with heavily-expanded primary supplies. The prices of primary products declined heavily relative to those of manufactures. As the recovery in Europe was retarded by ill-considered monetary policies, the result was a creeping agricultural crisis which did not end until the outbreak of the Second War.

In the 1930s investment in overseas areas practically ceased; agricultural countries one after another instituted restriction schemes to maintain prices. There was a shift of population to industry in agricultural countries which accentuated the difficulties of Europe in finding export markets. In Europe, menaced by the agricultural slump elsewhere, attempts to protect the farmers and subsequently to increase self-sufficiency further intensified the unbalance. But the cheapness of food hid the consequences of the continued, if slower, increase in population.

After the Second War the world outside the Western Hemisphere experienced a heavy reduction in primary output. The war had lasted longer. Much larger areas had been involved, including the most fertile parts of Asia. On the other hand, most countries were not prepared to entrust themselves to the vagaries of monetary management. Hence demand remained high for a much longer period than after the First War. After Congress took off price controls in the U.S. in 1946, and two crop failures in the Eastern Hemisphere intervened, primary prices rose considerably relative to manufactures. No doubt the position would have been even worse

had the North American agricultural production not increased considerably. But this could help only so long as dollars were available through grants, loans and from visible trade.<sup>1</sup>

An increased European population was, therefore, suddenly confronted with worsened conditions in obtaining food. If measures could be taken to increase primary output overseas—and it would be difficult to do so in the high standard areas without large-scale migration (because of the continuing relatively unattractive conditions in agriculture), the problems of Europe would be relieved at once from both ends.<sup>2</sup> It would have less mouths to feed and more food to do it with. A migration from Europe not accompanied by an increase in agricultural output would, as we shall see, do much less good and might aggravate the position of the highly industrialized countries in the West, e.g. Britain. Unfortunately, an increase in primary output is exceedingly risky. As demand for these products does not increase much when prices fall, while prices rise abruptly if supply is below a certain level (determined by the physiological need of the purchaser), the primary producer has an inherent interest to keep supply down: his income increases as scarcity is created. Thus some security must be provided if large-scale development is to take place. Moreover, there are grave difficulties in finance. The opening up of new areas and the intensification of production in the old, depends on capital investment which does not necessarily pay for itself in each instance, though its overall effects might well justify it in retrospect. All these difficulties contribute to the present intractable unbalance in European trade.

It would be possible to 'solve' this unbalance by restricting demand. No doubt prices would again fall, unemployment and malnutrition reappear together with an agricultural crisis. The planned equation of supply and demand at a high level, however, is a task much more difficult to perform.

<sup>1</sup> Cf. below on the influence of United States' aid and agricultural policy on the European terms of trade.

<sup>2</sup> It is amusing to note that a distinguished American economist at this juncture finally succeeded in proving that free trade is exactly as efficient in promoting the equality of earnings in different countries as migration—unfortunately only under classical assumptions, which are irrelevant to the present problem. Cf. Professor Samuelson, 'International Trade and Equalization of Factor Prices' (*Economic Journal*, 1948), and my answer, 'Static Models and Current International Economic Problems,' *Oxford Economic Papers*, New Series, No. 2.

## THE POST-WAR INTERNATIONAL ECONOMIC AGREEMENTS

The international schemes of reconstruction, devised by Anglo-American experts during the war, gave two answers to these problems. On the one hand, and only subject to a short transition period, a return to a regime of general convertibility of currencies and non-discrimination in commercial trading was decided upon, i.e. the return to free pricing in international economic relations. On the other hand it was agreed to put at the disposal of the world a fixed amount of additional international reserves and establish international agencies which were permitted to make certain exceptions, in case of need, to the basic principles laid down.<sup>1</sup> In the case of monetary arrangements the scarce currency clause was supposed to guard against the deflationary effects of a drain of the international currency reserves by one country having a persistent excess of exports. In the field of commercial policy, permission was given under certain exceptional circumstances to introduce quantitative restrictions on imports and give priority to imports of necessities.

The critics of this conception in their turn also emphasized the need for the intensification of commercial interchange between nations in order to increase productivity all round. Nor did they doubt that the elaboration of a code of international conduct was needed, for otherwise short-term considerations and sectional selfishness might lead to a trend towards national self-sufficiency in each of the members of the world system, to the detriment of all. Moreover, uncontrolled competition in beggar-my-neighbour policies could be expected between all, whenever instability occurred anywhere, leading to a threat of general unemployment. The 'critics' merely contended that an immediate attempt at restoring the uncontrolled sway of free markets internationally would prove a sorry failure, that multilateralism based on the outlawry of all reciprocal arrangements, on non-discrimination and convertibility, would, in the situation which was likely to emerge after the war, spread restrictionism and not cause expansion.

They claimed that the provision of additional reserves, the rôle of which was to cushion a deflationary pressure arising from deficiencies

<sup>1</sup> Even these exceptions were narrowed and the transition period in effect eliminated by the Anglo-U.S. Financial Agreement—unilaterally in respect to this country

in the balance of payments, were insufficient, and that the escape clauses such as the 'scarce currency clause' were largely ineffective.<sup>1</sup>

The second and at the same time more negative and more practical objection was due to the expectation that after the breakdown of the multilateral experiment there would be an excessive reaction towards the opposite extreme, with fatal consequences to the Commonwealth, Europe and Britain. 'Regional agreement will prevent the recurrence of competitive *national* isolationism, i.e. autarchy, in areas far more restricted geographically and economically than regions.'<sup>2</sup>

They also maintained that the new 'rules of the game' operated unfairly against poorer and smaller areas and would perpetuate their inferiority.<sup>3</sup> They were nothing but a simple extension of the doctrines of classical welfare economics based on a closed and perfectly competitive economy to the infinitely more complex problems of the present broken world economy. Even for a closed economy the whole analysis depended on the assumption that perfect competition and perfect foresight prevailed. Moreover, even perfect competition, the integral counterpart of the free-trade dogma, could not be demonstrated to bring about an optimum distribution or use of resources and output unless the distribution of wealth and income at the starting-point was 'optimal.' That perfect competition is in any case a figment of imagination, and that conclusions based on it cannot be applied without modification to the real world, was to a surprising extent ignored. The distribution of wealth even within a modern community possessing, and using to the full, all the paraphernalia of taxation and social services remains 'unjust,' in the sense that inequalities exist which cannot be attributed to the need to stimulate output. "If the conclusions of classical welfare economics cannot provide much guidance to domestic policy, still less do they apply in international relations, where there

<sup>1</sup> It is interesting to note that not a single one of the British experts seems to have realized that the quantitative relations between the U.S. and other countries' contribution was such that (unless the rules limiting borrowing—i.e. the purchase of foreign currencies—to 25 per cent of each borrower's quota were suspended) in the case of dollars a 'shortage' would not be declared until after 1½–2 years after the onset of the crisis. The shortage of a currency in the world economy was by no means equivalent to a shortage of the same currency in the Fund. Cf. below, Appendix I.

<sup>2</sup> Oxford Institute of Statistics, *The Economics of Full Employment*, 1944. Chapter V, p. 170.

<sup>3</sup> Cf. e.g. Sir Hubert Henderson, 'The Havana Charter,' *American Economic Review*, 1949, E. F. Schumacher, 'Export Policy and Full Employment,' and my paper on the I.T.O. Charter, *Bulletin*, op. cit., 1947.

is no taxing power and *any redistribution of international wealth and income can only come about by way of unilateral gifts and defaults, or by a conscious modification of the terms of trade.*

The 'critics of multilateralism' are neither opposed to all 'rules of the game' in international economic relations, nor are they opposed to multilateralism, if multilateralism is not conducted on the basis of rules which tend to perpetuate the inequalities of opportunity in the world. They want new rules which would energize the world to faster and more equal progress. "The tenets of the orthodox economic theory, based as it is on given means, known tastes, perfect knowledge, must not be used to discuss problems of growth, and problems arising out of the economic contact of different civilizations at different stages of their technical progress. Should the richer countries consent—in proportion to their recovery and wealth—to promote technical and economic progress in the poorer areas systematically, through grants and (low-interest) loans, this would obviously represent the most desirable solution, far superior to a system of planned and graduated discrimination. But the latter, in turn, is preferable to the uncontrolled sway of the price mechanism. It would, for example, be unwise to try to achieve 'balance' in the international payments of the United States by reducing her agricultural output to domestic requirements (or even below). It is clear that an agricultural revolution is taking place which will violently change value-productivity per man in agriculture, and the future relationship of costs in different countries are wholly incalculable. Moreover, the world at the moment needs the United States' output and the domestic social consequences in that country of the 'free' play of forces would be most undesirable. The alternative of systematic loans, of grants, however, could not be considered practical politics prior to the Marshall-Truman declarations.

This estimate of the future has been vindicated. Convertibility and non-discrimination, decreed by the Anglo-U.S. Loan Agreement, broke down not in a year or so, as the critics expected, but in a few weeks. Not the least cause of that breakdown was the complete loss of control over exchange transactions due to the re-introduction of convertibility, which had been predicted by all who had any experience of exchange dealings,<sup>1</sup> and had equally violently

<sup>1</sup> e.g. *ibid.*, p. 174.

been denied by its defenders.<sup>1</sup> The administrative chaos in British international economic relations which followed, inevitably resulted in extreme restrictionism, for neither was personnel available nor had preparations been made to do anything but cut imports to secure equilibrium.

As the first shock of the failure was overcome, and already before Marshall Aid had become a reality, a series of payments and trade agreements was negotiated by Britain which enabled the restoration of a better balance in international payments while maintaining the volume of total imports (despite the sharp increase in price), and a considerable increase in imports from non-dollar sources.

TABLE III

BRITISH IMPORTS (£ MILLION)

		<i>Sterling countries</i>	<i>Non-sterling countries</i>	
			<i>Western hemisphere</i>	<i>Other</i>
1947	m.a.	46.4	67.9	34.7
1948	Jan.	56.8	63.1	41.9
	Apr.	71.1	53.9	59.9
	July	65.8	64.3	55.5
	Sept.	58.5	60.2	50.7

#### • POST-WAR RECOVERY

The exhaustion of the American loans to France and Britain, the rapid dwindling of European reserves,<sup>2</sup> was undoubtedly exceedingly disappointing. Through the lend-lease settlements, U.N.R.R.A., loans, grants, and the military budget for civilian supplies for occupied territories, the United States made some \$10,000 million available in the two years after the war.

But however disappointing was the increase of the unbalance in the international payments of Western Europe, the importance of the work accomplished should not be underestimated. An impressive reconstruction of the war-devastated areas was achieved already in this period. The war left Germany and Central Europe

<sup>1</sup> e.g. the late Lord Keynes, House of Lords, May 23, 1944. Reprinted in *The New Economics*, ed. S. Harris, Knopf, New York, 1948, p. 375.

<sup>2</sup> Some \$5,000 million in less than two years prior to the vote by Congress of Interim Aid in 1947. S. Harris, *The European Recovery Programme*, Harvard, 1948, p. 128.

practically paralysed. The Western countries had also the gravest difficulties to contend with. Agricultural production was just over 60 per cent of pre-war in 1945-6. In 1946-7 this rose to roughly 75 per cent. Admittedly the 1945-6 and 1947-8 crops had been very adversely affected by the weather. Still, the recovery was prodigious. Industrial output must have been down to a bare quarter of pre-war in a great number of countries in the summer of 1945. Between the first quarter of 1946 and the second quarter of 1947 the following progress had been made:

TABLE IV<sup>1</sup>  
THE LEVEL OF INDUSTRIAL PRODUCTION(*a*) IN EUROPEAN COUNTRIES  
(Index Numbers—1938=100)

	Percentage of 1938 total European pro- duction ( <i>b</i> )	1946 First quarter	1947 Third quarter
Belgium . . . . .	3.24	77	102
Denmark .. . . .	1.61	93	108
France .. . . .	10.80	75	96
Germany (3 Western zones) .	16.62	22	37
Greece ( <i>c</i> ) .. . . .	0.75	44	71
Ireland .. . . .	0.41	103	113
Italy .. . . .	7.24	34	76
Netherlands .. . . .	3.12	62	91
Norway . . . . .	0.94	93	106
Sweden .. . . .	3.56	101	103
United Kingdom .. . . .	21.62	101	109
Total . . . . .	69.91		

(*a*) Including manufacturing, mining and building.

(*b*) Excluding U.S.S.R.

(*c*) Excluding mining.

<sup>1</sup> E.C.E., *Report 1948*, p. 3, Table I. For explanations see that *Report*.

By the middle of 1947 output, excluding Germany, was nearing pre-war level. In Britain it had surpassed it by some 10 per cent. The contribution of the U.S. (and to a much lesser extent, other overseas countries) to the total resources of Europe was even in 1947 probably under 7 per cent of the total. Given the strain



and ravages of the war, the result was remarkable. It was obvious, however, that it would be impossible to devise any longer-range policy on the hand-to-mouth basis on which European recovery proceeded after the abrupt termination of Lend-Lease and the strangling of U.N.R.R.A. The latter might have provided a nucleus for a long term solution. Unfortunately the growing tension between East and West sealed its fate. Yet its basic principle, i.e. that richer countries should contribute to the reconstruction of the poorer areas with resources and expert aid under proper supervision of the reconstruction plans, was on the right lines.

## CHAPTER 2

### THE MARSHALL PLAN

AMERICAN official opinion had become sceptical about the possibility of implementing the convertibility clause of the Anglo-American, and even the more general provisions of the Franco-American, loan agreements already in the spring of 1947, when the British Government and especially its official advisers were hopefully and with confidence looking forward to the restoration of convertibility. After Mr. Acheson's momentous farewell speech, on his relinquishing his position as General Marshall's deputy, the latter announced the willingness of the American Government to help in re-establishing the solvency of Europe, provided the European countries collaborated in helping one another. The response of the British Government was almost immediate. After the Soviet refused to participate in the European Recovery Programme, the way was clear for a Conference of the Western European Powers. A Committee of European Economic Co-operation was speedily established to work out a recovery programme. The intensely hostile campaign of the Communists against this plan, which culminated in the forcible establishment of open Communist hegemony in Eastern Europe, especially in Czechoslovakia, ensured the acceptance of the unusual burdens by the U.S. Congress.

The new approach was fundamentally different from the earlier attempt to re-establish 'normalcy,' to force a return to the pre-war system of 'free' markets. Instead of insisting, with patent hypocrisy, that unfettered market forces would bring about an 'optimum' of real income for the 'world,' and that they would automatically ensure the highest living standard for all, an attempt was made to estimate the requirements of Europe for foreign aid for a period of four years so as to be able to maintain tolerable living standards while resuscitating and reorganizing productive capacity. The problem of international 'equity' was not solved: the definition of what was 'tolerable' was not based on physiological requirements

but on accustomed standards. Nor were criteria elaborated for the scale of investment which was to be facilitated by U.S. aid. The estimates of each government were roughly adjusted to what was thought the 'traffic could bear.' It was only as between the U.S. and Europe as a whole that a redistribution of wealth took place.

The pressure of time prevented the elaboration of a coherent longer-term programme. The reports of the Committee of European Economic Co-operation<sup>1</sup> were not much more than emergency lists of imports essential to prevent an immediate cessation of supplies and thus render an attempt at recovery possible. The reports of the United States Department of State<sup>2</sup> were not different in character.<sup>3</sup> They were all based on estimated balance of payments deficits (especially with the dollar area), without a more exhaustive investigation of the policies, especially investment policies, of the countries concerned.

It should be remembered that at the moment when the proposals of the Paris Committee were submitted to Congress the United States had entered the second phase of her post-war prosperity. After a slight hesitancy in the first months of 1947 the United States experienced a further expansion of her production, partly as a result of the beginning of rearmament, partly because of the vast expansion of her overseas export surplus which rose to over \$11,000 million and, finally, because of the extraordinarily high level of domestic investment. There was no need for an 'export of unemployment.' All U.S. committees concentrated on inquiring how far grants-in-aid to Europe were compatible with monetary equilibrium. The effects of a cessation of exports to Europe were, therefore, little considered. It was the feeling that a Russian menace had to be countered which led to a collapse of the opposition to E.R.P. This fact becomes significant when the prospects of a longer-term solution are discussed.

After several reductions had been made in the original estimates of the Paris Conference, first by various official American com-

<sup>1</sup> Stationery Office, July-September 1947. Vol I, General Report; Vol. II, Technical Reports.

<sup>2</sup> European Recovery Programme. Commodity Reports, Washington, 1948.

<sup>3</sup> The reports of the various committees appointed by the President in the autumn of 1947 dealt with the effects of the Programme on the U.S. economy.

mittees, and the State Department, subsequently by Congress, the following allocation was agreed upon:

1948-9			
Austria .. ..	..	..	\$217 m.
Belgium-Luxemburg	..	..	\$250 m.
Denmark .. ..	..	..	\$110 m.
Eire .. .. .	..	..	\$79 m.
France .. ..	..	..	\$989 m.
Greece .. ..	..	..	\$146 m.
Iceland .. ..	..	..	\$11 m.
Italy .. .. .	..	..	\$601 m.
Netherlands..	..	..	\$496 m. (incl. \$84 m. for Netherlands East Indies)
Norway .. ..	..	..	\$84 m.
Sweden .. ..	..	..	\$47 m.
Trieste .. ..	..	..	\$18 m.
Turkey .. ..	..	..	\$50 m.
U.K... .. .	..	..	\$1,263 m.
Bizonia .. ..	..	..	\$414 m.
French Zone ..	..	..	\$100 m.
Total .. ..	..	..	<hr/> \$4,875 m.

The dollar aid voted covered a startlingly varied proportion of the imports from the dollar area. In the case of France it amounted to not less than 165 per cent, with Italy at 86 per cent and the United Kingdom at 78 per cent showing a more reasonable relationship. Even Belgium's dollar imports were almost half covered by the grant. The amount of gross aid per head of population varied between \$7 for Sweden and \$47 for the Netherlands (the United Kingdom being in the middle at \$24 with most of the larger countries), while Italy came surprisingly at the lower end of the scale at \$11.

Neither egalitarian nor basic economic considerations, such as, for example, the prospective increase in productivity as a result of the investment facilitated by the grant of aid, seem to explain the pattern of the distribution. A portion of the grants were given in the form of loans. The procedure represented a short-term measure to enable survival with that measure of hardship which was thought compatible with political stability. The difficulties arising out of the lack

of balance in intra-European trade were dealt with by a system of free grants (and in the case of Britain by an additional freeing of frozen sterling balances). The drawing rights established—equivalent to some \$810 million in the first year of the Marshall Aid—were restricted to use by the country to which it has been granted. Transfer was made dependent on the consent of the granting party, e.g. France was not able to use the sterling grant to pay a deficit incurred in her trade with Belgium except with the consent of the British Government. This was an important safeguard achieved by the British negotiators against some American pressure to restore complete convertibility within the European area. The latter might have involved Britain in exhausting her own credit lines granted by her creditors, especially Belgium, and thus in a loss of gold.

The greatest contributor to the scheme was Britain with drawing rights totalling the sterling equivalent of \$312 million (and \$209 million worth of sterling balances). Belgium granted \$218.5 million worth of drawing rights, almost equivalent to her dollar receipts under the Marshall Plan. France with \$333 million credits received was the greatest beneficiary. The net aid received under the Marshall Plan was, therefore, substantially different from the *gross* amounts. Intra-European trade, the increase of which was a precondition of a balance with the outer world, was revived even if in a rigid framework. An International Clearing Scheme was instituted, but in practice remained restricted to a direct compensation.<sup>1</sup> Transferability of credit balances could not be arranged on any important scale. As we shall see, this was the result of a serious divergence between the policies of member countries which forced those with high employment to take steps to guard their reserves.

Whatever the shortcomings of this approach may have been theoretically (or even from a longer term practical viewpoint), it represented an unprecedented departure in constructive economic policy. Moreover, and this was also of great importance, for the first time a clear picture emerged of the magnitude of the problem. At last the world was enabled to envisage clearly the possible ways of solution. At the same time the U.S. legislation authorizing aid to Europe provided for the drawing up and presentation of a four-year

<sup>1</sup> About one-fifth of the trade, or less than \$100 million, was conducted within the scheme in this way in the first six months, the rest by drawing rights. O.B.E.C. Report, p. 50.

plan of recovery. The fact that Congress only authorized funds until the end of the current U.S. fiscal year (June 30, 1949)—in fact, it first only voted appropriations until April 1, 1949—made a determined attempt to obtain general European agreement on the basic elements of such a plan essential. Only an agreed programme could count on rousing the imagination of public opinion in the U.S. and thus appeal to their generosity. And it must always be borne in mind that unprecedented sacrifice was demanded from the American taxpayer. Even given the tense international political situation and Mr. Truman's victory in the elections of 1948, which strengthened the anti-isolationist elements, it was necessary to impress Congress that the will and capacity existed in Western Europe to establish a viable economic unit capable of standing on its own feet. At the same time a unique occasion occurred to enlighten U.S. opinion on the basic needs of Europe and thus secure consent and co-operation to such modifications of earlier international agreements as would impede this task.

#### THE YEAR OF RECOVERY

The exhaustion of the American loans to Britain and France, the suspension of the convertibility of sterling, resulted in drastic changes in internal and international economic policy in Western Europe already prior to the passing of the various U.S. aid measures. Moreover, after long delays the Anglo-American Military Government in Germany at last agreed upon a drastic currency reform. The demobilization in the allied countries and the consequent reduction of the drain of (overseas) military expenditure also contributed its share. Last but not least, the passing of time had its own beneficent effect. Productive capacity was repaired, the most constricting bottlenecks in production and transport were eliminated, stocks began to accumulate.

In consequence European production, which showed signs of flagging in the first half of 1947, rapidly improved. If we exclude Germany it has increased well above pre-war level, and even if Germany is included it has regained its pre-war level. The favourable weather had an equally beneficial effect on agricultural production, though its rate of recovery remains slower.

TABLE V<sup>1</sup>

## THE LEVEL OF INDUSTRIAL PRODUCTION

(Index numbers based on 1938)

Country	1938=100		
	1946	1947	1948 <i>a</i>
Austria <i>b</i> .. . .	40 <i>c</i>	48	74
Belgium .. . .	89	106	115
Bulgaria .. . .	122	145	170
Czechoslovakia <i>b</i> .. . .	..	87	102
Denmark .. . .	101 <i>c</i>	116	130
France <i>d</i> .. . .	79	95	108
Germany: U.K./U.S. Zone <i>e</i> ..	29	34	51
Greece . . . .	56	71	77
Ireland .. . .	110	116	137
Italy .. . .	61 <i>c</i>	81	87
Netherlands .. . .	74	94	112
Norway .. . .	94	108	118
Poland . . . .	79	104	133
Sweden .. . .	136	138	143
United Kingdom <i>f</i> . . . .	100	108	121
Total of above countries:			
including Germany .. . .	72	83	96
excluding Germany .. . .	88	100	113
U.S.S.R. <i>b</i> . . . .	76	93	118

*a* Provisional*b* The base of the annual index numbers for Austria and Czechoslovakia is 1937, for the U.S.S.R., 1940.*c* Estimate. For details, see Appendix II*d* Excluding the Saar*e* The indices of the U.K./U.S. Zone have been given the weight of the three Western zones. See Appendix II.*f* The annual indices (1938=100) have been obtained on the basis of 1946 weights. If 1935 weights were used, the index for 1947 would be 115 (1938=100) and would raise the European total (including Germany) by two points.<sup>1</sup> E.C.E., Report 1949, p. 4, Table 1. For sources cf. the Report.

TABLE VI<sup>1</sup>  
 THE LEVEL OF AGRICULTURAL PRODUCTION  
 (Index numbers—1934-8=100)

<i>Country</i>	1946-7	1947-8	1948-9
Austria.. ..	80	72	80
Belgium .. ..	73	71	70
Bulgaria .. ..	67	71	.
Czechoslovakia .	80	62	80
Denmark .	94	76	100
Finland .. ..	72	71	80
France . . . .	83	75	85
Germany <sup>a</sup> .. ..	64	61	70
Greece .. ..	78	90	80
Hungary . . . .	57	67	85
Ireland . . . .	97	91	..
Italy . . . .	86	86	90
Netherlands ..	88	85	90
Norway .. ..	95	86	95
Poland . . . .	46	59	70
Portugal .. ..	97	95	95
Rumania .. ..	59	80	..
Spain <sup>b</sup> . . . .	90	85	90
Sweden . . . .	103	103	105
Switzerland ..	113	98	100
Turkey . . . .	101	123	125
United Kingdom ..	102	103	115
Yugoslavia .. .	56	69	..
Total Europe: <sup>c</sup> including Germany	78	76	85
excluding Germany	80	80	90

The index numbers refer to the crop year July-June.

<sup>a</sup> Four zones.

<sup>b</sup> Base of the index numbers: 1930-34.

<sup>c</sup> Excluding the U.S.S.R.

<sup>1</sup> E C E, *Report* 1949, p. 17, Table 14. For sources cf. that *Report*.



An equally impressive progress could be observed in the restoration of the European balance of trade, despite the further worsening of her terms of trade which cost her almost \$1,500 million in the cost of imports.

TABLE VII<sup>a</sup>

## EUROPE'S BALANCE OF PAYMENTS

Thousand millions of dollars in current prices

	1947			1948 <sup>a</sup>		
	<i>United States</i>	<i>Other non-European countries</i>	<i>Total</i>	<i>United States</i>	<i>Other non-European countries</i>	<i>Total</i>
Europe's imports (f.o.b.) .. ..	6.1	7.8	13.9	4.8	10.0	14.8
Europe's exports (f.o.b.) .. ..	0.9	5.5	6.4	1.1	7.5	8.6
Balance on trade account .. ..	-5.2	-2.3	-7.5	-3.7	-2.5	-6.2
Income from investment (net) .. ..	—	+0.6	+0.6	—	+0.5	+0.5
Transportation (net) .. ..	-0.7	+0.3	-0.4	-0.2	+0.5	+0.3
Other invisibles (net) .. ..	+0.2	-0.5	-0.3	+0.3	-0.5	-0.2
Balance on invisibles account .. ..	-0.5	+0.4	-0.1	+0.1	+0.5	+0.6
Balance on goods and services .. ..	-5.7	-1.9	-7.6	-3.6	-2.0	-5.6

<sup>a</sup> Provisional, based on incomplete data for the year<sup>1</sup> E C E. Report, op cit., p. 112, Table 71.

The adverse visible balance with the United States was reduced by almost a third, the overall deficit by only slightly less. The shift of demand to non-American supplies was accomplished with some success, though it was partly responsible for a further increase in import prices which aggravates the problem of relations with the dollar area as the shift of demand away from the latter tended to depress prices there. The British balance of payments showed even greater improvement. The deficit on current account for the whole year was reduced from £630 million to £120 million, i.e. below

the level of the Marshall grants. Invisible items contributed not less than £300 million to this.<sup>1</sup> In the second half of the year a small surplus was achieved. So much for the claims of those economists who denigrated Government policy.

Unfortunately this substantial improvement was accompanied by a further widening in the rift between the policies of Britain, the Netherlands, and the Scandinavian countries on the one hand, and the Latin countries and the Bizone of Germany on the other. In the former the 1947 crisis led not merely to the maintenance of a disinflationary budget policy, but also to a tightening of direct controls which had been relaxed immediately after the war. In consequence they were able to maintain a high net investment rate despite the improvement in the balance of payments. In the second group all pretence at control was given up; and (except France) a more or less savage policy of deflation was instituted which soon led to an acute crisis of unemployment.

In Germany we are confronted with the sorry spectacle of unemployment and surplus of raw materials in the building trade amidst gigantic ruination. Moreover, the absence of control (and the unjust basis on which currency reform was carried through, which enabled the entrepreneurs and traders to enrich themselves) has led to a co-existence of savage hardship with detestable excesses of luxury. The position in Italy is not much better, while the Belgian deflation also produced similar results.

Even in England the 'disinflationary' school exerted some influence—and characteristically achieved the opposite of what they intended. General measures taken suddenly threatened with localized unemployment and this led to a rapid decontrol. The most important examples are building and clothing. Investment and export plans respectively were not duly co-ordinated with raw material allocations and plans for the alternative re-employment of the displaced people. Consequently makeshift arrangements had to be made which led to a premature increase in clothing consumption when new markets, especially in the Western Hemisphere, could

<sup>1</sup> This was partly due to the completion of investments in oilfields (£100 million) and to a decrease in military expenditure abroad. The attempt of certain economists to connect the improvement with a cut in home investment is obviously incorrect. Equally fallacious is the view that the decrease of the foreign balance must be 'offset' by an equal 'disinflation'. A large part of the British deficit was not 'used' for 'domestic' purposes and never entered national income. Its cessation did not demand an offsetting diminution of spending power at home.

have been conquered and the foreign exchange gained used for the import of raw materials to increase investment, e.g. timber for housing. This process was reproduced in the case of building where house-repair licensing was lifted on work below £100, thus further dissipating skilled labour and material. It has been shown that in practice redeployment can only be enforced by disinflation through unnecessary unemployment. General measures are not subtle enough to divert labour from less essential work in those localities where alternative essential work is available. Nor is it particularly desirable that the consequences of failures in planning or of outside shocks should be entirely borne by shifting labour rather than concentrating on particular bottlenecks and easing the problem through new investment and reorganization of the industry. Selective measures were not taken because of the resistance of the interests threatened. The British Government and the Trade Unions moreover could not come to agreement either on policies which would minimize these problems or on a positive policy of wage differentials to promote redeployment within and between industries. The absence of energetic action on these lines, coupled with decontrol, resulted in a deterioration in the relative position of the working class, which raised new problems.

Last but not least, the policy of decontrol enforced a lowering of the investment target.

A comparison of the investment actually achieved in 1948 and that planned for 1949 with 1938, the only pre-war year for which detailed estimates are available, shows the advance which has been achieved. In 1938 gross investment amounted to 17 per cent of the national income, with net investment running at 7 per cent, depreciation being charged at the rate of 10 per cent. By 1947 this had increased to 9 per cent and 21 per cent respectively, and in 1948 to 11½ and 23 per cent. The fluctuations in the volume of investment were as follows:

TABLE VIII<sup>1</sup>  
UNITED KINGDOM INVESTMENT IN FIXED CAPITAL  
(Millions of dollars in 1938 prices)

	Gross	Net
1938	3,450	1,500
1946	2,000	50
1947	3,660	1,660
1948	3,850	1,800

<sup>1</sup> E.C.E., *Report 1949*, p. 47, Table 33.

It must not be forgotten, however, that 1938 was a year of relative depression and that the relative position of Great Britain has very seriously deteriorated in comparison to the United States, because of the war-time losses in the United Kingdom. Moreover, we should take into account that most of the post-war investment in the U.S. has not yet had time to make its effects felt. The state of relative manpower shortage also promoted the hoarding of manpower. Hence it is probable that productivity per man in the U.S. will show far greater than normal improvement over the next few years.<sup>1</sup> Thus, from this particular point of view, not much solace can be derived from recent calculations of the Economic Commission for Europe showing a relative improvement in productivity, especially in Sweden and Britain, in comparison with the United States since the war, however important these findings might be in respect to British monetary policy.<sup>2</sup> The trend of relative productivity was steadily against Britain and Europe since the first calculations were made for the period 1907-24,<sup>3</sup> and insufficient time has yet elapsed to come to any secure conclusions. British productivity and, consequently, the level of wages are so low, the menace of future competitive struggles so acute that much greater attention and effort ought to have been devoted to this basic task.

Investment capacity depends first on the absolute level of national real income per head and its distribution. It depends, secondly, on the willingness to forgo current consumption. American national income per head is roughly double in money terms at official rates of exchange of the British level, and taxation is far less progressive. Thus Britain, in order to equalize American superiority in this respect, would have to undergo some strain. In point of fact, the British investment ratio at almost 23 per cent of the gross national product compares with an American ratio in 1948 of just under 16 per cent. Nevertheless, if we compare investment in manufacturing

<sup>1</sup> Productivity improved explosively in America after the collapse of the post-war boom of 1919-20. If that historical example has any bearing on the present situation, an improvement of between 10 and 20 per cent over the next year or so is by no means out of the question.

<sup>2</sup> E.C.E., 'Relative changes in labour costs in industry'. Productivity in the United States per man hour (1935-8=100) rose to 119 by 1946 as against 104 in Britain. Since then the United States remained almost stationary at 120 while British output per man year rose to 122. Even more favourable to Britain are comparisons of output per man hour. In Britain the increase in the last ten years is 18 per cent as against only 10 per cent in the United States.

<sup>3</sup> Cf. L. Rostas, 'Productivity Comparisons in Selected Industries in America and Britain,' and T. Barna, 'Productivity and real income in Britain and the United States,' Oxford Institute of Statistics Bulletin, 1946.

we see that investment per head of manufacturing employment still remains less than one-third of that in America, and that investment in manufacturing industry is not merely absolutely but relatively to national gross product much lower in the United Kingdom than in America.

TABLE IX

GROSS INVESTMENT IN MANUFACTURING INDUSTRY<sup>1</sup>

Great Britain, 1947-9

U.S.A. 1947-8

	1947		1948		1949
	in millions of the national currency				
1. Total gross investment in construction and plant in manufacturing industry .. ..	U.S.	U.K.	U.S.	U.K.	U.K.
	10,590	370	11,780	405	450
in millions					
2. Total employment in manufactures.. ..	15.9	7.25	16.27	7.34 8.2 <sup>2</sup>	— 8.24 <sup>2</sup>
in units of national currency					
3. Investment per head of manufacturing employment .. ..	666	51.03	724.5	55.15 49.38 <sup>2</sup>	— 57.61 <sup>2</sup>
per cent					
4. (1) as proportion of Gross National Product	4.57	3.91	4.63	3.86	4.13 <sup>2</sup>
in millions of the national currency					
5. Total Gross Investment (non-farm) Plant (and equipment) and Construction (including Housing, etc., and Public Construction)	27,660	1,375	33,760	1,895	1,995
per cent					
6. (1) as proportion of (5)	38.29	26.91	35.24	21.37	22.56

<sup>1</sup> Sources: Cmd. 7645 and the President's Economic Report.<sup>2</sup> New series Cmd. 7647, p. 32

Moreover, a much larger proportion of total investment was concentrated in manufacturing industries as compared with the United Kingdom, i.e. 35 as compared with 21 per cent in 1948. This is explained by the wearing out of capital in transport in Britain as well as the much greater allocation for housing construction. However that may be, it is quite clear that a serious further worsening of the British position with respect to manufacturing efficiency is inevitable unless methods are found to increase productivity without investment.

The very fact that British manufacturing efficiency seems relatively low, even if we take into account the much smaller degree of mechanization and power supply per head, indicates that much could be done in this respect. Of the measures proposed, standardization, concentration of production, redeployment, reorganization of factory layouts, and last but not least, reform of the wage system, exceedingly little has been performed. The preliminary steps taken by the appointment of working parties already contained some of the weaknesses of the post-1914 British approach to these problems. Their membership was representative, almost corporatist, rather than chosen for their special knowledge. This resulted in a tendency to justify the existing state of affairs, especially the lack of mechanization, on the basis of questionable calculations. Instead of taking into account the rising wages necessary to attract sufficient labour (or alternatively basing their calculations on a wage rate which had some relationship with the minimum standard which should be established), existing wage rates were mostly used. Thus a misleading picture emerged greatly complicating further efforts at reform.

Nevertheless, the majority of the working parties reported in favour of establishing development councils with fairly extensive powers, charged with the promotion of research and, possibly, of exports. Enabling legislation was passed in 1946. Subsequent resistance of the industries concerned in most cases prevented the establishment of such councils. In the cases where resistance was not encountered, or was overcome, either concessions had to be made which rob the organizations of much of their power to promote progress, or the personnel chosen seems strangely incongruous to the task with which they are charged. Such other sporadic attempts to increase productivity as were undertaken remained on a minor

scale. They were, moreover, endangered by the growing fear of trade unionists of unemployment. The clamour for disinflation and the tone of much of the discussions which suggested that an important section of public opinion favoured an increase in unemployment to restore discipline and efficiency, undoubtedly aggravated the suspicions of the trade unions and made advances more difficult.

Nor were the declared intentions of the Government for 1949 reassuring. Instead of pressing on with the reorganization of British industry, which necessarily entails heavy investment, the Government contemplated a slight reduction of total investment at home while using the full amount of Marshall Aid requested, i.e. some £200 million for external investment, and permitting an appreciable increase in consumption. As decontrol over consumption was pursued at an accelerating rate in 1949, this meant a further increase in the requirements for real resources per unit of expenditure. In other words, the Government's plans implied a further decrease of efficiency of the economic system in meeting a given amount of money demand: e.g. a less full use of railroads, of the entertainments and similar industries, all of which would not release real resources in proportion. With the dismantling of the control mechanism, moreover, the flexibility of Government policy also decreased. There was less power to channel demand towards 'innocuous' outlets. Should, therefore, on account of any unfavourable turn in the international position, the need arise to release real resources, e.g. for exports, or should Britain suffer a diminution of the supply of imports, a greater degree of deflation will become necessary, other things being equal, *as the demand for real resources can no longer be reduced directly but only as an incidental consequence of a general reduction of demand*, which includes demand for services, etc., not absorbing resources which can be utilized elsewhere. Disinflation, however, in order to be successful in this sense, must go a long way,<sup>1</sup> causing a lot of unnecessary harm by decreasing general enjoyment, and increasing social tension. Those, however, who have capital can maintain their consumption, irrespective of taxation. The distribution of real consumption, therefore, worsens appreciably, raising further dangerous social problems.

As the present year opened, Britain was dangerously nearing the

<sup>1</sup> Cf below, Chapter 4 and also Chapter 6. The alternative, on the views of the adherents of a 'small' deflation.

position in unplanned economies, uneasily poised between inflation and deflation, incapable in case of need to counter a deflationary turn abroad by direct measures because of the dismantling of the control apparatus. Moreover, as a result of decontrol, social inequality increased—if only slightly—and thus demands for wage increases reappeared: the whole policy of wage stabilization was imperilled, at a dangerous juncture.

We might sum up in saying that the turn of the year 1948–9 saw the successful completion of the important preliminary stage of convalescence. At the same time it also witnessed the failure of true co-ordination of European economic policies.

## THE LONG-TERM PLANS

### (a) *The Framework*

The first emergency having been overcome, the preparation of a more detailed programme could be undertaken.

In compliance with the Economic Co-operation Act, the European governments were asked to submit to the Organization for European Economic Co-operation (O.E.E.C.), which had, in the meantime, been established by the recipient countries in Paris, for consideration and transmission to the U.S. Administration their plans in respect of the use of Marshall Aid in the four-year period of the European Recovery Programme. These should have been transmitted to Paris by October 15, 1948, i.e. before the results of the U.S. election were known and some estimate could be formed about the probable attitude of the U.S. Congress and Administration in the crucial years of reconstruction. The Organization was to have reported in the middle of December, i.e. two months were given only to the essential and much more difficult task of working out a combined programme. The Organization itself was merely the Secretariat of a Council consisting of National Delegations. It could, therefore, in theory not initiate planning on a super-national scale.

In point of fact the timetable was not kept. Nor yet was the delay used for a modification of the plans, including the British, which had been drawn up in time, in the light of the vital changes in prospects, due to the result of the U.S. elections. The national plans were not drawn up on the basis of identical statistical concepts, and are even theoretically not comparable. Even these most primi-



tive conditions of the work of O.E.E.C. were not fulfilled. In practice the wide differences in the willingness and the capacity of the various member governments to implement any plans is yet a further obstacle to supra-national, regional co-operation. If there is no guarantee that certain vital supplies will be forthcoming from within the region, countries such as Britain (but also Belgium and Germany) because they are dependent on foreign trade cannot fully accept plans which imply a reorientation of their own policy.

In the event the leadership could only be taken by Britain. Neither the knowledge nor administrative capacity in economic matters was available in most other European countries. The example of the Paris Conference of 1947, at which the British delegation successfully steered the proceedings, should have stimulated a determined effort. The British Government, not unnaturally, remained sceptical about the possibility of effectively reorganizing Western Europe. On the one hand it was uncertain whether it would be able to get its political and economic conceptions accepted; on the other it was fearful lest policies should be dictated to them which would enforce domestic measures incompatible with their policy. Hence it favoured the establishment not of a strong organization which could establish a framework for European co-ordination, but a weak secretariat subordinated to an executive committee consisting of heads of national delegations. The work on functional issues (transport, steel, etc.) is performed by national delegations pursuing—mainly short-term—national advantage, not held in check by a powerful documentation of the regional requirements. The consequence is that the problems of Western Europe as a whole tend to be overlooked in efforts to arrive at piecemeal compromise, which leave the basic weaknesses of the system as a whole uncured. The caution of the British Civil Servants disregarded the fact that Britain's position with her relatively high standard of life and her great dependence of foreign trade is more precarious than that of most other countries.

While the sceptical attitude might have been justified, it tended to overlook certain real opportunities as well as opposite dangers. Not only does Britain stand to gain more by a successful solution of the problem of Europe—the planned opening of markets for manufacturing and increase in the supply of primary products. She is also likely to lose most should the attempt fail and an internecine

struggle break loose between European manufacturing exporters. The rise of governments in Europe which reject the British approach to economic and social problems was not countered even where British influence could have been effective. The concentration on the defence against Communism which was interpreted in the sense of a duty to give aid to clerical and other, fundamentally anti-Socialist, elements, and persuade the Socialist parties to collaborate with them at the risk of their annihilation, further encouraged this tendency.<sup>1</sup> Thus the failure to secure U.S. help while possible, exposed the domestic policy of the Government to a serious threat.

It should have been clear that, in the absence of a coherent plan elaborated under British leadership which would have given some hope of consolidating Europe, the whole concept of the European Recovery Programme would be endangered, despite the experiences of the 1946-7 crisis, by a reaction in the U.S. towards the Hull-Clayton concept of 'non-discrimination' which would be fatal to the emergence of a stable and progressive Western Europe. The more widespread the territory for which planning is undertaken, and the greater the international specialization, the more quickly can the Continent as a whole recover. Some calculated risks should therefore have been taken by Britain: having thus given proof of her willingness to undertake sacrifices for European recovery, Britain would have been in a strong position to insist on the full co-operation of other European countries in carrying out the plan agreed upon.

The U.S. from the outset was consistently urging the need for close European integration and insisted on dealing with the European governments through the Paris office. The British feelers at short-circuiting the European Organization through a very strong direct representation at Washington, however tentative (and, to some extent, subconscious, resulting directly from the unparalleled experience of British officials in negotiating with American authorities), aroused strong suspicions which are difficult to dissipate. The fact that responsibility for relations with the European organization was at first not satisfactorily resolved, and co-ordination between British departments was less than perfect—as is usually the case when foreign political and economic questions are intertwined, that in the vital formative period the British representation was rather

<sup>1</sup> Cf. below, Chapter 5.

weak, all this contributed to the uncertainty of touch which placed the Government somewhat on the defensive.

The next few years will see the success or failure of recreating a working world economy and restoring the functions of Europe in it which have been undermined by two wars. The problem before us is to ensure so rapid an expansion of world real income that world trade in manufactures would expand in spite of industrialization of overseas territories. If such an expansion cannot be achieved the economic basis of Western European countries might be weakened to such an extent that their present populations could not be supported at their accustomed standard of life, despite technical progress. And the British plans and conceptions are the most important single element in the pattern of European reconstruction.

In the end this approach was not adopted by Britain.

Consequently both the British and the Continental European plans submitted were strictly national in character. They did not and could not represent a solution of the Western European crisis. Not only were they to a considerable degree incompatible with one another—as the O.E.E.C. Interim Report on the national plans points out rather frankly—but they were framed with some disregard to the probable course of development both within and outside Western Europe.

To some extent this was due to the assumptions which were laid down by the American administrators and were applicable to all countries. The material ones are as follows:<sup>1</sup>

1. That there will be no war or even a substantial diversion of economic resources to war preparation.
2. That a high level of employment will continue throughout the world and particularly in the U.S. It has not, however, been apparently assumed that the United States as a surplus country will 'play the orthodox game' and inflate slightly to help in readjusting international balance.
3. That there will be a high level of world trade (or more precisely, that demand for European exports will continue on a high level irrespective of their own need to control imports).
4. That the terms of trade will remain at the 1948 level.

We shall presently discuss the implications of these assumptions

<sup>1</sup> Cf. O.E.E.C. *Interim Report on the E.R.P.* Vol. I, Paris, December 31, 1948, pp. 11-12.

and shall argue that they are not only wildly optimistic but also that they do not offer a consistent basis for the restoration of a satisfactorily working multilateral economy. It was laid down, nevertheless, that the Western European countries should secure balance in their overall payments with the world as a whole, and in particular with the Western Hemisphere. No indication was given, however, of the United States' policy in detail except for the general assumption that 'high level' of employment and trade will persist. This seemed to imply

- (a) that there will be no general depression and thus a fall in demand, and—together with the further assumption of unchanged terms of trade—
- (b) that the reconstruction in Europe and the vast expansion of the United States' productive capacity will not turn the terms of trade against Europe and thus enforce new adjustments through devaluation, or through other measures tending to induce a depression.

As we shall argue, this is hardly conceivable without a planned policy of international development of the world economy and in particular of the 'backward' areas. There is little sign that these essential assumptions are being realized, or at least that the respective governments dare to enlighten their public opinion about them.

#### (b) *The European Programmes*

##### (i) *Production*

The production programmes of the O.E.E.C. countries envisage overall increase in national output of some 20 per cent over 1938 or 35 per cent over 1947. This average figure covers important differences between the plans of different countries.

##### *Britain*

It is significant that the British plans are by far the most sceptical. In the first of the estimates<sup>1</sup> for the current Marshall year,<sup>2</sup> manufacturing output was estimated at 25–30 per cent above pre-war. As manufacturing output in the second quarter of 1948 was already almost 25 per cent above pre-war, this estimate in fact meant the acceptance of little, if any, progress. For the second Marshall year, ending June 1950, the estimate was between 30 and 35 per cent,<sup>3</sup> and

<sup>1</sup> Cmd 7545.

<sup>2</sup> Ending June 30, 1949.

<sup>3</sup> Cmd. 7572.

for 1952-3, 40 per cent of 1938.<sup>1</sup> This is a surprisingly small figure, equal to or only just above the actual rate of progress in the inter-war period from 1924 onwards, i.e. over good years and bad and including the Great Depression.<sup>2</sup> Yet, gross investment at 20 per cent of gross national output is some  $33\frac{1}{3}$  per cent above pre-war, and net investment, equal to about 10 per cent of national income, almost double the pre-war rate. It is, moreover, somewhat more concentrated in industry, i.e. 33 per cent of the total as against some 25 per cent.<sup>3</sup> On this basis alone a far greater increase of output might have been expected. The estimate implied a resignation on the part of the Government to the failure of their attempt to force a reorganization of industry. A reorganization of layout and reform in the running and maintenance of machinery could have yielded a large part, if not the whole, of the projected improvement in productivity. Moreover, re-deployment and an appropriate alteration of wage systems might have been attempted in co-operation with the trade unions, and might have produced an overall gain amounting to as much as 5-10 per cent in the four-year period.

On the whole, however, the decisive advance must depend on the skill and persistence of the Government, in the face of dangerous attacks by politicians and experts, and popular demands for 'relaxing austerity,' in increasing and improving capital equipment. This is the more important as a fully employed economy cannot depend for its resilience and flexibility on an industrial reserve army. Thus it is essential to have adequate stocks of raw materials and components on the one hand, and of surplus manufacturing capacity on the other, to be able to meet unexpected changes in demand without unemployment. Every economy must have reserves; a progressively managed economic system will build up reserves, not of wasting manpower, but of productive capacity.

Had the advance in productivity and production been calculated on the basis of greater success of the Government's policies, the

<sup>1</sup> The greatest expansion was contemplated in agriculture, which is to be expanded 50 per cent above pre-war and 15 per cent above its wartime peak, at the height of the Nazi blockade of Britain. The relationship between the increased investment and output in manufacture and agriculture respectively did not, as it seems, receive any further and more serious consideration since the announcement of the agricultural programme in the middle of the crisis of 1947.

<sup>2</sup> Cf. N. Kaldor, Appendix C of the Beveridge Report on *Full Employment in a Free Society*. His calculations (carefully safeguarded by explicit assumptions) seem to have been vindicated against the scorn of orthodoxy completely bewitched by the fuel crisis.

<sup>3</sup> Excluding house repairs of about £80 million.

contemplated rate of investment could also have been increased. Indeed, it seems odd that despite the increase in national output by some 20 per cent in the four-year period, the ratio of investment to consumption is kept unchanged. In the absence of any agreement solving the problems arising out of the probable renaissance of German and Japanese competition, and out of deflationary pressures developing even before the end of Marshall Aid, it would have been prudent to contemplate more determined efforts. Moreover, a bolder British plan would have facilitated such agreement. It seems that the Government were impelled by their desire to relax controls. Whatever the reasons for the particular estimate eventually adopted, its consequences on inter-European co-operation were grave.

The greater the expected increase in productivity in Britain, the more favourable the chances of a direct or indirect satisfaction through exports of the dollar-requirements of this country and the closer knit the European plans, the more naturally multilateral can be the character of the restored world economy. Conversely, the greater the immediate effort at increasing productivity at home, the more multilateral can be the character of the British plan, and the greater are the chances of the eventual favourable solution of the whole problem.

If the British Government were actuated by the desire to take account of a possible U.S. slump without saying so, this procedure was certainly misguided. A setback in the U.S. would certainly upset all European and especially British planning to a far greater extent than the estimates implied. On the other hand, the targets put forward failed to provide the basis for any substantial contribution to the European problem and thus were bound to fail to elicit any support. They fell between two stools.

#### *Other O.E.E.C. Countries*

The production targets of the other European countries—and especially of Western Germany—were much more ambitious. The average rate of growth was estimated at some 5–6 per cent per annum. The report of the O.E.E.C. commented with commendable frankness that

“The achievement of the national programmes is conditional on an increase of some 15 per cent in output per man-hour during

the next four years. This is a bold assumption. Yet no other assumption is more important. . . . Whether it can be fully effected in the period of three and a half years is, however, doubtful, and therefore no effort should be spared to secure as great an increase as possible."

TABLE X<sup>1</sup>

ESTIMATES OF THE LEVEL OF AGRICULTURAL AND INDUSTRIAL  
PRODUCTION IN O.E.E.C. COUNTRIES

(Index numbers based on 1938 and 1947)

Country	1938=100				1947=100	
	1947		1952-3		1952-3	
	Agri- culture	Industry	Agri- culture	Industry	Agri- culture	Industry
Denmark .. ..	76 <sup>a</sup>	111	110 <sup>a</sup>	138	142 <sup>a</sup>	124
France .. ..	81	96	114	151	141	157
Germany: U.K./U.S.						
Zone .. ..	80 <sup>b</sup>	40 <sup>c</sup>	100 <sup>c</sup>	110 <sup>c</sup>	125 <sup>d</sup>	275
Italy .. ..	80	81	105	140	131	173
Netherlands .. ..	88 <sup>b</sup>	101 <sup>b</sup>	102	134	116 <sup>d</sup>	133 <sup>d</sup>
Norway .. ..	80	108	110	140	138	130
United Kingdom ..	123	114 <sup>e</sup>	150	140 <sup>e</sup>	122	123 <sup>e</sup>

<sup>a</sup> Animal products only

<sup>b</sup> 1948.

<sup>c</sup> Base of the index numbers, 1936.

<sup>d</sup> Base of the index numbers, 1948.

<sup>e</sup> Manufacturing only.

<sup>1</sup> E.C.E., *Report 1949*, Table 99, p. 179.

Source: The figures are derived from the long-term programmes published by the member countries of the O.E.E.C.

But given the grave disturbance in the balance of productive capacity, and the consequent artificial depression of productivity, a well co-ordinated plan should easily be able to achieve this progress. The Report discussed some of the measures (e.g. standardization, specialization) needed to obtain rapid expansion, but the examples of certain preliminary preparations quoted (e.g. railway wagons) are clearly insufficient. Moreover, as we shall see presently, the tendency towards national autarchy is hardly conducive to increased overall efficiency. Longer hours and the re-deployment of labour which are discussed at great length are not impossible, but would demand

a much closer social coherence and unity than obtain on the Continent.

Nor is there any attempt made to indicate the means of ensuring the achievement of these aims. An uncontrolled economy open to unfavourable influences from abroad, and subject to spasms of speculative bouts can hardly guarantee steady progress. The scepticism of the Report might be justified, but it is partly in the inhibitions in the discussion of the essential details of the implementation of the plans that the cause of the pessimism must be sought. The limitations of the procedure adopted are laid bare by this failure. Without assurance that the continental European plans, especially the French which are both quantitatively and qualitatively the most important, will, in fact, be executed, consequential modifications in other programmes are pointless, and might even be dangerous.

### (11) *The International Aspects*

Much the same comments can be made in respect of the international aspects of the production programmes and the plans to retrieve balance in international payments, both overall and in relation to the dollar area. The problem was made almost insuperable by two factors:

(a) The U.S. Government resolutely refused to give any indication of any measures it intends to take in order to mitigate the inequality of opportunity of the non-American countries and at the same time mitigate the dollar crisis. Such measures might take the form either of non-tied U.S. loan or grant aid to non-European countries to help in their development, of a permission to introduce or secure preferential treatment for European exports in Europe and elsewhere, or of unilateral tariff concessions to promote European export to the U.S.; and

(b) most European countries are unable to give binding undertakings on the implementation of plans mutually agreed upon because they have dismantled all apparatus of control and are subject to the vagaries of the monetary swings of uncontrolled markets subject to foreign shocks and governed by the changing short-term profit expectations of entrepreneurs.

Unfortunately, the *British* Government, mainly looking to its problems, not only failed to win the co-operation of other Euro-



pean countries in favour of its conception of European recovery, but invited hostility and isolation for what was termed to be the 'nationalistic' narrowness of its plans. American disapproval could and should have been anticipated, not so much because all European planning necessarily implies discrimination against American exports (unless, indeed, a planned investment programme for the Western World as a whole could be elaborated with U.S. co-operation), but because the British plans in European relations were frankly bilateral (though they were based on a multilateral closing of the dollar gap). This procedure, which was inviting the charge of hypocrisy, was exceedingly shortsighted. It can be mainly attributed to the failure of the British Government to grasp the essentials of democratic planning.

Be that as it may, the British Government hoped to turn the deficit in the balance of payments of some £650 million in 1947 into a surplus of £100 million by 1952. The projected pattern of recovery was interesting.

TABLE XI

U.K. BALANCE OF PAYMENTS BY AREAS, 1952-3 (\$ MILLION)

	<i>Western Hemisphere</i>	<i>Other non-participating</i>	<i>Sterling Area</i>	<i>Participating countries x</i>	<i>Total</i>
<b>Outgo:</b>					
Imports . . .	1,888	1,177	3,216	1,749	8,030
Shipping . . .	267	46	162	303	778
Travel . . .	40	4	121	200	365
Interest, Profits, Dividends	255	38	153	100	546
Normal amortization ..	95	.	29	..	124
Total .. ..	2,545	1,265	3,681	2,352	9,843
<b>Income:</b>					
Exports and re-exports ..	1,455	990	3,492	1,440	7,377
Shipping . . .	351	47	478	261	1,137
Travel .. ..	150	5	65	40	260
Interest, profits, dividends	205	25	430	40	700
Normal amortization ..	..	13	..	56	69
Other receipts (net) . .	93	11	32	564	700
Total . . .	2,254	1,091	4,497	2,401	10,243
Balance . . .	-291	-174	+816	+49	+400
<div> <div>x Non-sterling</div> <div>+ Surplus.</div> <div>- Deficit.</div> </div>					

A comparison with the first half of 1948 yields the following results:

- (a) the value of imports would be permitted to rise by 10 per cent only<sup>1</sup>;
- (b) invisible expenditure (net) was to be cut by £70 million (despite an increase in expenditure on travel of some 100 per cent), i.e. mainly Government expenditure;
- (c) debt interest and service was to be allocated £170 million instead of £120 million;
- (d) exports were to increase by roughly £300 million p.a.; but exports to Europe were to be actually cut;
- (e) shipping income was expected to rise by £50 million;
- (f) other receipts were to rise by £100 million.

The progress towards these aims is shown by the following table.

TABLE XII

U.K. BALANCE OF PAYMENTS ON CURRENT ACCOUNT (£ MILLIONS)

		Imports f.o.b.	Exports and re- exports f.o.b.	Balance on visible trade	Invisibles (net)	Total
1946: <sup>1</sup>	1st half .. ..	502	392	—110	—120	—230
	2nd half .. ..	690	498	— 92	— 48	—140
1947:	1st half .. ..	725	511	—214	—121	—335
	2nd half . . .	815	591	—224	— 71	—295
1948: <sup>2</sup>	1st half . . .	896	730	—156	+ 16	—150
	2nd half .. ..	872	820	— 52	+ 82	+ 30
1949: <sup>3</sup>	1st half . . .	950	905	— 45		
1952/3 <sup>4</sup>	(half-yearly rate)	1,000	920	— 80	+130	+ 50

<sup>1</sup> Ref. *Hansard*, Vol. 456, No. 8, September 23, 1948. Columns 137 and 138

<sup>2</sup> Cmd. 7520, p. 3, Table I.

<sup>3</sup> *Hansard*, July 14, 1949 Columns 803-4 Provisional

<sup>4</sup> Planned. Cmd. 7572

*The geographic redirection* of imports and exports, however, has not been as successful, and for good reasons. The Western Hemisphere deficit in the first half of 1948 was almost at an annual rate of £400 million as against the contemplated £150 million in the last year of the Plan. The surplus towards the sterling area was at the annual rate of £140 million as against £225 million. The favour-

<sup>1</sup> The general assumptions quoted above should be remembered (p. 35).

able balance with O.E.E.C. countries was at the rate of £80 million as against £10 million. So far as British policy is concerned these figures do not seem to support the contention that a stricter control over exports, the case for which was discussed elsewhere,<sup>1</sup> is not needed. Yet there seems to have been further relaxation even in this direction.

*Autarchy.* The plan envisages an increase of national output by some 30 per cent above pre-war, with manufacturing output leading the expansion with 40 per cent above 1938, and a reduction in imports to 80–85 per cent of pre-war as compared with 68·3 per cent in 1946 and 77·4 per cent in 1947 (88·6 per cent in the third quarter). Thus the ratio of imports to output is roughly to be cut to 60 per cent of pre-war. Increased autarchy might become inevitable. But it was surely ill-advised at that stage to put forward plans which imply that little regard was to be paid by Britain to the needs of the other members of O.E.E.C. The explanation, somewhat too complacent, that 'in the first place the United Kingdom is making a major contribution to the solution of the European problem as a whole by surmounting the United Kingdom dollar problem' does not provide any solace for other Western countries. The maintenance of the present standard of life in Western Europe depends on a co-operative increase in European productivity as a result of pooling European resources and markets. The British contribution to the solution of their problems can hardly consist in attempting to make sterling a hard currency, which would undoubtedly be followed by retaliation in kind.

Multilateral European trade cannot be restored without conscious planning, and that planning must fulfil two conditions: greater security must be given that other European nations will in fact fulfil their programmes and deliver the exports they promise. And it must be made perfectly clear to all, including the U.S., that Britain can only provide dollars for imports into Britain if those dollars can be earned by her exports, i.e. in fact only if the U.S. is willing to finance development abroad.<sup>2</sup> This does not mean, however, that at the preliminary stage British plans should have been drawn up on the basis that these conditions cannot be satisfied. The British plan, even as it was formulated, involves a multilateral acquisition

<sup>1</sup> 'The British Balance of Payments.' Oxford Institute of Statistics, *Bulletin*, July 1947.

<sup>2</sup> Cf. below.

of dollars: it assumes that an (at present non-existent) import surplus of, or foreign lending by, the U.S., will permit the conversion of Britain's export surplus to the sterling area into dollars. The same approach was not adopted for our dealings with Europe.

This procedure has been defended on a double plea. It was argued that 'it is not convertibility that produces a balance of trade, but rather the existence of a balance of trade that alone makes convertibility possible.'<sup>1</sup> If this statement is to mean that a policy aiming at the immediate restoration of general convertibility without strictest controls and planning demands a restrictive monetary policy, i.e. a sharp deflation, which would decrease the standard of life far more than any gain that might result from the 'freer' payments system, it seems incontrovertible. If, however, it is to mean that Britain cannot collaborate in minimizing the fall in the standard of life of Continental Western Europe which would incidentally follow if British imports from those countries were to be restricted—which it obviously intends to convey—it proves too much. The balancing of payments can be worked in different ways, and it was extremely short-sighted to abandon *a priori* hope of obtaining effective U.S. co-operation in solving this problem which indeed Britain alone can no longer solve. The fact that Britain cut its demand for aid by 25 per cent (as it seems, against American advice) did not diminish European suspicions and hostility. This was to have grave consequences.

It seems, therefore, that a case could have been made for planning for an increase in 'unessential' imports from the 'participating' countries and budgeting for a greater increase of British overseas exports. The fact that British exports need only to increase from the contemplated 150 per cent to 160 per cent of 1938 (as against an initial post-war target of 175 per cent) or by 17 per cent of the 1948 volume is an additional reason: Britain was in a far better position than most other European countries and could help to ease the readjustment of others. On the other hand, Britain stood more in danger as a result of a renewed change in the trend of U.S. policy and would have been wise to demonstrate to her utmost her determination to contribute to its success, even though explaining frankly the conditions which must obtain if she is in fact to be in a position to co-operate.

<sup>1</sup> *The Economist*, January 1, 1949, p. 4.

Was the plan not running the danger of giving the impression that the United Kingdom intended to treat the minor sterling problem of Europe in the same mistaken way as the United States has treated the major dollar crisis prior to 1947? This aspect of the plan had to contribute to the rupture of European solidarity, which should have been avoided.

*The European plans* follow an identical pattern. We find the same striving for greater self-sufficiency. This shift towards autarchy would be natural if it were on a *regional* basis. But while Western European exchanges with their own dependent territories are to increase to almost 140 per cent of 1938, the level of intra-European trade is barely to be restored to that level.

The international specialization in manufactures is to be seriously cut even within Western Europe, and the (insufficient) increase in intra-European trade will be restricted mainly to raw materials (agriculture, petroleum, timber). There is no sign of a co-ordination in these plans. The E.C.E. prepared an interesting measure of the attempted national (as contrasted with regional) self-sufficiency.

Continental European countries wish to earn a surplus of some £50 million in their trade with the U.K. to be used for purchases in the Commonwealth. The U.K. programme does not accept any deficit in its relations with Europe. The British plans are obviously sceptical about the feasibility of, first, increasing primary supplies from the Commonwealth, and, secondly, increasing British exports to the sterling area. But for the Pacific Dominions the restriction of their markets in Europe such as the British targets imply would be as unfavourable, as the inability of Britain to finance her purchases from Canada by dollars earned by triangular trade with the U.S. was for the North American Dominion. Thus a wider plan should have been aimed at, which solves the sterling problem as a minor aspect of the dollar 'shortage.' An attempt to force Western Europe to compete with the wide plains of other continents in agricultural bulk products would certainly decrease value productivity and should, if possible, be avoided except as a by-product of a plan for increasing *total* world agricultural production.<sup>1</sup>

<sup>1</sup> This was only one among several inconsistencies in the diverse national programmes. For a thorough, if rather devastating, review of these plans cf. the E.C.E., *Report* 1949, pp. 177-201. E.g. the export programmes of textiles, machinery are not matched by the import programmes, etc

TABLE XIII<sup>a</sup>

THE TRADE OF THE O.E.E.C. COUNTRIES IN CONSTANT PRICES

(Thousand millions of dollars in 1948-9 prices)

Item	1938	1947	1948-9	1952-3	Change from 1947 to 1952-3
Imports from the outside world .. . . .	13.0	12.5	12.4]	12.9	+0.4
Index .. . . .	100	96	95	99	
Imports of the United King- dom, France, Benelux and Portugal from their own dependent overseas terri- tories .. . . .	1.6	1.7	2.0	2.2	+0.5
Index .. . . .	100	108	125	138	
Imports of O.E.E.C. coun- tries from other O.E.E.C. countries and their depen- dent overseas territories	9.5	6.2	7.8	9.6	+3.4
Index .. . . .	100	65	82	101	
Total Imports .	24.1	20.4	22.2	24.7	+4.3
Index . . . . .	100	85	92	102	
Exports to the outside world	8.0	5.4	6.2	10.6	+5.2
Index .. . . .	100	68	78	133	
Exports of the United King- dom, France, Benelux and Portugal to their own de- pendent overseas territories	1.2	1.3	2.0	2.4	+1.1
Index .. . . .	100	105	165	194	
Exports of O.E.E.C. coun- tries to other O.E.E.C. countries and their depen- dent overseas territories ..	9.3	6.2	7.7	9.9	+3.7
Index .. . . .	100	67	83	107	
Total Exports .. . .	18.5	12.9	15.9	22.9	+10.0
Index .. . . .	100	70	80	124	

<sup>a</sup> E.C.E., Report 1949, p. 185, Table 102 For sources cf. that Report.

TABLE XIV

CHANGES IN THE LEVEL OF TRADE IN RELATION TO PRODUCTION IN

O.E.E.C. COUNTRIES

(Index numbers—1938=100)

Item	France		Germany: Western Zones		United Kingdom		Total <i>b</i>	
	1947	1952-3	1947	1952-3	1947	1952-3	1947	1952-3
<i>Indices of Production and Trade</i>								
Industrial and agricultural production	90	140	43	108	109	141	85	129
Trade with the outside world: <i>c</i>								
Imports ..	139	107	43	114	81	78	96	99
Exports ..	65	145	3	128	101	146	68	133
Trade with member countries: <i>d</i>								
Imports ..	72	110	19	81	53	78	65	101
Exports ..	74	118	24	78	98	110	67	107

*Ratio of Trade Indices to Production Indices*

Trade with the outside world <i>c</i> in relation to production:								
Imports ..	154	76	100	106	74	55	113	77
Exports ..	72	104	7	119	93	104	80	103
Trade with member countries <i>d</i> in relation to production:								
Imports ..	80	79	44	75	49	55	76	78
Exports ..	82	84	56	72	90	78	79	83

*b* Including other member countries not specified.*c* Excluding trade with the dependent overseas territories.*d* Including trade with the dependent overseas territories. The exports and imports of those O.E.E.C. countries which possess dependent overseas territories to and from their own dependencies are, however, excluded.<sup>1</sup> E.C.E., Report 1949, p. 188, Table 105. For sources cf. that Report.

The cardinal question of a Western European plan in this respect, too, is the capacity of its members to implement their undertakings. It is unfortunate that O.E.E.C. has not devoted more space to the positive aspect of its duties: the proposal of policies instead of acquiescing in rather vague if outspoken criticism.

Similar considerations apply to the relations of Western to Eastern Europe. If we could assume that peace will be assured, and that a strengthening of Eastern Europe will not be militarily disadvantageous, the dependence of Europe as a whole on overseas supplies could be considerably reduced.<sup>1</sup> The possibilities of increasing primary production are great even if we accept the fact that the industrialization of those countries will be speeded up. The national plans and the O.E.E.C. Report both give the impression of an unresolved dilemma: on the one hand they envisage a volume of trade which, on the worst hypothesis, would be distinctly dangerous. On the other hand they are not prepared to go as far as was, e.g., envisaged in the first Report of E.C.E., and thus reduce the problem of the extra-European unfavourable balance to really manageable proportions.

Considerable success was achieved in increasing intra-European trade. The clearing agreements negotiated and the scheme of grants based on Marshall Aid have broken the complete deadlock, but were too rigid to encourage a rational development.<sup>2</sup> In 1946 trade between participating countries was only 50 per cent of pre-war. By the fourth quarter of 1948 it had recovered to 90 per cent. The gold-clauses of the payments agreements, however, continued to exert a restrictive pressure on trade as most members (and especially Belgium and Switzerland) preferred to receive gold or dollars to goods obtainable even in the sterling area. Only if quantitative reciprocal agreements could be negotiated could this effect be obviated so long as the serious difference in the monetary tension prevailing between the different countries does not permit the conclusion of agreements which provide for the reciprocal holding of

<sup>1</sup> Though the extent of substituting Eastern for Western supplies, without first undertaking or facilitating Eastern European investment, should not be exaggerated. Total trade between Eastern European countries including the U.S.S.R., the development of which was pursued with determination, was only \$1,104 million in 1948, the exports of Eastern to Western Europe in 1938 were \$1,152 million, and in 1948 \$1,275 million. The overseas imports of the O.E.E.C. countries amounted to \$13,900 million in 1948, of which \$4,600 million from the U.S.

<sup>2</sup> Cf. above and my article 'Intra-European Clearing,' *Bulletin*, September 1948.



currencies without limit, agreements which would, therefore, have an expansionist and not a restrictive bias.<sup>1</sup> The 'grant' scheme, on the other hand, was not based on the relative real needs of countries on the basis of a co-ordinated plan. It was based on their current balance of payments which is a function not merely of their relative poverty but also of their monetary and financial policy. It certainly did not give any incentive to the restoration of solvency by their own exertions. No scheme would contribute to recovery, however, in which competition for scarce dollars is enforced by general deflation and unemployment.<sup>2</sup> The dilemma can be resolved by grants followed up by a co-ordination of national plans.

So far as the balance with the outside world, and more especially the U.S. is concerned, the O.E.E.C. Report had a salutary disillusioning effect. The imperfect organization of European co-operative planning rendered its task exceedingly difficult: 'the examination of the national plans has been confined to 1949-52,' thus 'little allowance could be made for the possibility of developing trade by systematic co-operation between Europe and other major economic regions; it may be desirable to stimulate production outside the participating countries.' It is noteworthy that up to 50 per cent of exports are to consist of metals, equipment and other engineering and related products. The demand for these products is notoriously unstable. Hence without extra-European planning the European programmes are necessarily subject to qualifications which the O.E.E.C. duly records. But more important and urgent than the qualification of the report would have been an authoritative analysis (surely possible without even first waiting for the details of the national plans) of *how stable markets for Europe are to be secured*.

The O.E.E.C. doubts whether the export programme, providing an increase in exports from \$6.2 billion to \$10.6 billion between 1948-9 and 1952-3, is possible without an increase in the *share* of Europe in total exports, and implies that in South America this could only be done *at the expense of the U.S.* If this were indeed true, the

<sup>1</sup> The Belgian case shows, however, that a balance without controlled adjustment might have to be obtained at the cost of very heavy unemployment.

<sup>2</sup> A measure of the folly of the deflationary policy can be found in the inability of many countries to accept free gifts due to internal monetary stringency. Owing to the intricacy of the accounting of Marshall Aid it was not known at the time of writing how much of the U.S. appropriation was not utilized. Only \$677.2 million of the total drawing rights of \$832.4 million (dollar equivalents) were utilized in intra-European payments. Germany used relatively the smallest proportion of the aid granted.

doubts cast on the feasibility of the plans would be more than justified. But is this necessarily so? If the volume of equipment contemplated even in the reduced estimates of O.E.E.C. can be sold, that implies so vigorous an expansion of the world economy as a whole, that that particular consideration would hardly arise. Even total exports of \$8,500 million (as against \$6,200 million in 1948-9 and \$5,400 million in 1947) are impossible if the expansion is to take place through an international free-for-all fight (mainly by private firms) for *normally* expanding markets (not to say if a depression supervened). The contemplated \$10,600 million are certainly beyond any reasonable expectation, though not beyond physical capacity. It represents only 20 per cent of the planned increase in European output and is only one-third above the actual level reached in 1948. But this does not mean that the very conservative British 'target' for 1952 of an export volume almost unchanged as compared with the end of 1948, is 'sounder.' If overseas development and co-operation cannot be organized even that figure is too optimistic. At the stage reached at the end of 1948 the O.E.E.C. would have performed the best service if it had given a factual analysis of the measures needed to enable the restoration of an expansive, multilateral world economy in which Europe can play its part.

Unfortunately there was at no point either strong British leadership or a clear realization by most other European governments of the issues involved. The latter hoped to regain solvency by an international scramble in which the countries pursuing the most reactionary social policy and having most unemployment would be bound to 'win.' The national plans show that even on the basis of unduly optimistic assumptions a substantial dollar deficit of \$1.3 billion must be expected. If the view of O.E.E.C. is to be believed, imports would have to be restricted to 75 per cent of the volume anticipated in the national programmes or a deficit of \$3 billion faced. A 'radical' change in European domestic policy would, in the view of O.E.E.C., increase exports by some \$1-1.5 billion to \$9.5-10 billion. But even this achievement would necessitate serious cuts in imports. Not *hâs* O.E.E.C. stated what the repercussions of such policy would be on business activity and production both within and outside Europe. Clearly a 'radical' change in policy would involve large-scale unemployment. It is impossible to agitate for

'disinflation' and then greet with astonishment the advent of the buyers' market and comment on the difficulty of exporting, which is the direct consequence of the policy advocated.

This brings us to the chapter on the *use of resources* in Western Europe. The ratio of gross investment to total national output as projected, varies between 12 per cent of the national income and 23 per cent in the Bizone of Germany. In most cases it is 19-20 per cent.

As could be expected, the rate of investment is, except for Bizonia, more or less proportionate to the level of national income per head. Given the inequality in the distribution of available income, this rate of investment, however, represents in most countries a heavy burden on the poorer classes (with a parallel gross excess in luxury consumption) and will lead to continuous unsettlement. The O.E.E.C. Report recognizes that inflation will threaten throughout the period if anything like this programme is attempted, despite the continuation of a substantial U.S. aid which will hardly fall short of 5 per cent of total European production; but the Report does not discuss the measures by which the necessary 'voluntary or compulsory savings' are to be secured. Nor is there any reasoned statement on the relationship between the level of aid approved and the investment programme. Thus it is impossible to judge how, and how correctly, the total plans were drawn up. Despite growing unemployment at the end of 1948, the O.E.E.C. did not feel impelled to call attention to the deflationary threat to these plans. Yet it was this aspect of the problem which began to assume the gravest importance at the beginning of 1949.

The lesson of the bitter inter-war years seems to have been completely forgotten. The European governments have clearly arrived at a dead end.

## CHAPTER 3

### THE PROBLEM OF 'CLOSER' UNION IN WESTERN EUROPE

THE difficulties in the way of elaborating a comprehensive European Recovery Programme and national plans or policies have proved to be formidable. This was only to be expected, as it was impossible to devise a European programme without having first elaborated national plans and the national plans had to be devised without real knowledge of the intentions of the other members. The negative character of the first O.E.E.C. Report need not therefore be taken too tragically. It should have performed a very necessary function of dispelling certain dangerous illusions about the quantitative aspect of our problem. Unfortunately it had exactly the opposite effect. And the fact that nothing tangible emerged in the fateful seven months since its appearance, a period in which the deflationary crisis has made some headway, shows that further disappointments must be expected if a radical new departure cannot be secured with full American consent and collaboration.

The negative and sceptical character of the activities of O.E.E.C. has strengthened those voices in Europe and the U.S. which demand (not seldom as a cloak for selfish and anti-social policies) something 'spectacular' and 'apt to capture American imagination.' On the other hand, developments in the United States, in combination with the 'disillusionment' of hopes encouraged at the passing of the aid measure, have once more brought to the fore those forces and ideas which were responsible for the misguided and bankrupt international agreements concluded at the end of the war. The discussion of these tendencies is necessary before a more constructive solution can be outlined.

#### THE EUROPEAN MOVEMENT

Few dominant political ideas have undergone such startling changes in substance and in the composition of their protagonists as the movement for a closer Western European Union.

A closer Western Union (after the magnificent but abortive gesture of Mr. Churchill at the end of the battle of France of 1940, which had little if any detailed political or economic programme behind it, and should only be regarded as an extreme sign of determination to resist the Nazis) was envisaged at first, in the latter part of the war, by a small minority on the Left who were disturbed by the emergence of two supernational Mammoth Powers of extreme antagonism. It was clear that Europe would finally lose its hegemony of world power. The traditional basis of British policy, maintaining naval supremacy and preventing the domination of Europe by any one Power would consequently also be destroyed. It was equally clear that a loose association of independent sovereign states could not guarantee peace as the potential international political differences between the victorious powers were far too acute for them to be prepared to trust 'majority votes' to judge impartially in possible disputes. No absolute code of behaviour can be elaborated to deal with political issues between parties whose basic convictions are fundamentally dissimilar. The protagonists of Western Unity in those days hoped, therefore, that a Western European Union might emerge under British leadership, strong enough to mediate authoritatively between the two extremes. As Europe would be primarily—and almost exclusively—interested in avoiding armed conflict which would finally ruin her whatever the outcome, it could reasonably be hoped that this rôle of mediator would be accepted as springing from genuinely non-aggressive motives. It seemed at that time likely, moreover, that Britain and Western Europe would adopt an economic and social system different both from the American economic and Russian political 'way of life.' The strengthening of the economic basis of Western Europe was therefore essential if the attempt at a compromise solution embodying both political and economic democracy was to succeed.

The hostility of the Soviet Union at the closing stages of the war against the proposal of a Western Union was immediate. Communists wrongly conceived it as a camouflage for preparations of a renewed attack. Their wrath was concentrated on Britain, and they hoped to come to some direct agreement with the U.S. This hostility, whatever its reasons,<sup>1</sup> had catastrophic consequences. The

<sup>1</sup> Cf. Professor Blackett's analysis of the aims pursued and methods selected in using the atom bomb just prior to the collapse of Japan. The 'Political and Military Consequences of Atomic Energy.' No convincing answer has yet been made.

period in which the Left was potentially dominant in Continental Europe was exhausted by the stultifying resistance of the local Communists against closer co-operation with Britain. The Soviet animosity, on the other hand, weakened all those in Britain who demanded a break with Mr. Churchill's policy of backing every bankrupt reactionary regime. They were not only morally shocked at the ramshackle collection of new 'allies' which the Labour Government was acquiring, but were also convinced that successful resistance against revolution could not be based on a return to the corruption and injustice of the pre-war regimes in a growing number of countries. The effectiveness of their protests declined, though their fears were fully justified by events. In one country after another Social Democracy succumbed: once the choice between extremes was posed, the centre found little support either internally, or from Britain. The continuity of Mr. Churchill's policies was made possible, and in certain instances even inevitable by this vicious circle. Compromised figures of the pre-war days and of collaboration with the Nazis revived.

Nor was a progressive Western European Union opposed by Russia and the Communists only, though, in the event, it was that opposition which sealed its doom. It incurred also the concentrated wrath of the United States and all 'internationalists' who, undeterred by the ghastly failure of the League, were still searching for 'absolute' principles (which, like 'non-aggression' or 'non-discrimination,' have a knack of turning out to be disguises for the defence of far from 'moral' vested interests). The United States, freshly established as the paramount power in the world, was in no mood to accept modifications of her traditional policy of 'equal access' to markets (however unequally huge her competitive strength had become). Nor was she prepared to see a spread of 'Schachtian' State-intervention and Government trading at the very moment of the collapse of the Nazi regime. It was useless to argue that the acceptance of the 'rules of the game,' imposed by the United States at Bretton Woods and subsequent conferences, did not mean that there would be no 'blocs' but only 'one world'; that it meant that two huge and opposing blocs would arise and that the non-Soviet bloc would come under the complete domination of the United States. Nor did the argument make any appreciable impression that the rules of the game would leave the non-American countries in a position of

hopeless struggle, unable to catch up with her economic development and forced into periodic crises by her overwhelming economic power. 'Internationalism' thus turns out to be the negation of the socially positive state. Without similarity in political outlook, economic endeavour and social desire, it necessarily deteriorates into a feeble agreement with the highest common platitude of the most reactionary Great Power.

Ironically enough it was Soviet policy which transformed the idea of Western Union as an association of progressive European communities pledged to full employment, social justice, and a planned reconstruction and reorganization of their economic systems to attain higher levels of productivity and standards of life, into a politico-military coalition against Communism, having no common approach to domestic social problems.

The so-called United Europe Movement was not launched as a struggle for economic rehabilitation in Europe. It was conceived as a political gesture of defiance to Russia, gestures for which—at his 'finest hour'—Mr. Churchill has become so famous. It incidentally captured the imagination of the masses of Europeans hoping to find a way out of the certain decline of their status in the world. They had been twice ravaged by wars in one generation. They longed for peace and felt that peace could best be secured by unity. They did not—and could not—weigh carefully the implications of the proposal on their everyday life. The economic aspects of this Defensive Union were elaborated subsequently, and bear the imprint of an awkward afterthought. They do not even envisage clearly the implications of the expectation of a Russian attack, which initially gave rise to the agitation.

If the policy of the U.S.S.R. were similar to that of Nazi Germany, if, therefore, it consisted of active war preparation with the intent of overrunning or overawing countries by violence, or the threat of violence, *from the outside*, the logical economic policy of a defensive union on its borders must necessarily be based on strategic estimates. 'Defence is greater than opulence': no matter what the economic attractions of a balanced reconstruction might be, they will have to be rejected in favour of military considerations. Thus an estimate would have to be made of the probable depth to which the prospective enemy attack could penetrate. In this glaxis there would be no sense in erecting expensive capital installations, for they

would have to be destroyed if they are not to benefit the enemy. Given the discrepancy between the land-power of the Soviet Orbit and Western Europe, it would be rash to assume that any territory north of the Pyrenees or east of Dover could be defended. Indeed, in the hottest and most hysterical period of the 'cold' war, American commentators adopted exactly this point of view. They therefore argued that any help extended to Western Europe and even to Britain was a waste of resources better employed in building up arsenals and defence systems in North America.

This attitude cannot consciously be adopted by Europeans, as it would condemn them to perdition. But it explains the continued loss of capital through illegal manipulations which has been estimated at \$200 million in the case of the Western Zones of Germany, and must reach a multiple of that sum in the case of the administratively weak Latin countries of the West. If we remember that this represents up to 10 per cent of total net investment, we might begin to grasp the dangers of the spread of such views. It is regrettable that a considerable body of opinion maintains and diffuses it, in the—perhaps subconscious but certainly mistaken—hope, that it will induce the U.S. to further military and economic help. The fact that if the United States adopted it, the logic of this view would certainly not have beneficial results for Europe, seems psychologically repressed.

From this major inner inconsistency of the beginnings and of the rise of the demand for political union in Europe follows its economic and social stultification. If one is only united in storming defiance and thundering challenge to an outer 'foe,' it is unlikely that harmonious collaboration can ensue in details, except within a community bound together by strong ties of tradition, when danger is imminent. Even then, as Mr. Churchill should remember, concessions to the dissatisfied must be made to procure union. Moreover, heroic postures are rather fatiguing—especially in peace—if not buttressed by concrete material results. Unfortunately none of the more or less vociferous adherents of a closer Western Union have considered in detail the material consequences of their proposals.

The plain fact is that even the five Brussels Powers, not to speak of the O.E.E.C. countries, have exceedingly varied economic and social systems at very different stages of their development. This is clearly brought out by a comparison of their national income and



the division of their working population between agriculture and manufacture:

TABLE XV<sup>1</sup>

COMMODITY OUTPUT PER HEAD

(Dollars of 1938 purchasing power)

<i>Country</i>	1938	1947	1948
United States . . . .	225	323	331
United Kingdom . . . .	182	181	200
Total Europe, excluding Germany ..	97	94	104
Total Europe, including Germany ..	113	90	101
Ireland .. . . .	115	115	131
Sweden .. . . .	203	236	237
Denmark .. . . .	167	156	179
Norway .. . . .	133	141	148
Netherlands .. . . .	132	108	124
Belgium-Luxemburg.. . . .	147	143	154
France .. . . .	136	124	139
Switzerland .. . . .	185	234	233
Italy . . . . .	71	55	58
Austria . . . . .	101	53	73

<sup>1</sup> E.C.E., *Report* 1949, p. 21, Table 16.

It is seen that the difference between the output per head even before the war was proportionally greater between Italy and Great Britain than between the latter and the United States. Even if we leave out Turkey and Greece<sup>1</sup> it is difficult to conceive how immediate unification between such vastly different areas is to be brought about without grave social and economic disturbance. A vast effort over a generation at least, and imaginative planning as well as a will to sacrifice would be needed. What is even more disconcerting is that even on the basis of Marshall Aid they seem in no position to raise their investment in fixed capital to levels which would indicate a gradual alignment of their standard of life (Table XVI).

Not only do these countries differ considerably in the level of their economic development, but they are, unfortunately, confronted with similar problems; they are, apart from certain potentially important exceptions, competitive rather than comple-

<sup>1</sup> The inclusion of which into the O.E.E.C. was dictated entirely by politico-military reasons. This was in any case a mistake, as their problems proved to be entirely different from, and complicated the solution of those of, the rest, and might have been dealt with either by a separate military aid scheme or in conjunction with a scheme for the Middle East which is overdue on any count.

mentary in character. And economic development in the past fifty years has rendered them more rather than less competitive. Nor,

TABLE XVI<sup>1</sup>

NET INVESTMENT IN FIXED CAPITAL PER HEAD OF POPULATION

(Dollars in 1938 prices)

	1938	1946	1947	1948
Norway . . . . .	38	40	59	55
Sweden .. .. .	32	41	52	42
Denmark .. . . .	27	25	31	32
U K. .. . . .	31	1	33	36
Netherlands . . .	34	13	25	27
France . . . . .	5	12	16	16
Belgium.. . . .	—	12	16	—
Italy .. . . .	12	10	9	10

<sup>1</sup> E.C.E., *Report 1949*, p. 48, Table 35.

as we have seen, will this trend be altered by the proposals put forward by the member governments to O.E.E.C. if they remain unchanged. Yet it is acknowledged that one of the important causes of the relative backwardness of European productivity is the growing national autarchy, the effort to produce everything, however inefficiently, within the national borders. A stop must surely be put to this drift towards collective economic debility which renders Europe incapable of competing in third markets with the United States at equal terms, i.e. without cutting the standard of life, and thus reintegrating herself in a world economy. There is much to be said for the impatience with the fiddling attempt hitherto made and for the yearning for a 'full solution'.<sup>1</sup>

## CUSTOMS UNIONS

The most widely canvassed of the schemes for a closer economic integration of Europe, which is to bring salvation, is that of the formation of a Customs Union. It has already led to the conclusion of a pact between the Belgo-Luxemburg customs area and Holland, which is to come into being in 1950, and another somewhat more tentative agreement between Italy and France.

These proposals ignore that trade between countries is no longer

<sup>1</sup> Even the International Socialist Conference of Vienna in 1948 favoured such union

automatically regulated by prices, and that the price-level is no longer automatically determined by the flow of gold from one country to another. So long as the world believed that in economic matters Government intervention merely frustrated itself, customs unions could indubitably bring about 'unification.' Tariffs were the only barrier between the competing firms in different countries.<sup>1</sup> Should one of the countries experience a boom which would carry incomes relatively above those in other countries, its purchases abroad would increase, its sales possibly diminish because of the increase in incomes, imports would rise above exports, and the demand for foreign currencies would rise. As its currency, as well as other countries', was firmly linked to gold, it would become profitable to ship gold to make those excess payments. This would force the autonomous Central Bank of the gold-losing country to restrict credit, the boom would cease, incomes would fall away again, and 'balance' would be re-established at the cost of losses and unemployment. True enough, even in the nineteenth century powerful countries, especially Britain, would exert an unusual influence. Its booms and slumps would be propagated in the whole world economic system,<sup>2</sup> and the smaller countries in the peripheries would be put at some disadvantage by this instability. But the United Kingdom was a relatively small part of the world economy specialized on industry, and its international transactions played a rather large, if not determinant, rôle in influencing her own internal economic conditions.<sup>3</sup> No tariff barrier kept imports of any kind of goods out of her markets. Moreover, Britain was not merely the largest market for the products of other countries, but also the main source of capital for development. Her imports, unlike those of the U.S., increased sharply with increasing national income. Complementary trade between lender and borrower was established, instead, as after the 1920s, a growing competitiveness. The resilience of the system was buttressed by the increase in population and by migration. Thus the resultant pattern of economic evolution was not intolerable even to the weaker nations. In any case only

<sup>1</sup> Their consequence on the weaker economy might be devastating even in that case, of course. Only the mechanics are discussed here.

<sup>2</sup> Cf. Triffin, 'National Central Banking and the International Economy,' *Review of Economic Studies*, 1946-7, No 36, p 53.

<sup>3</sup> Cf. 'The U.S. and the World Economy,' *op. cit.*, and above table p. 6, n. 2

'Utopians' and 'extremists' believed that successful intervention in the ebb and flow of economic activity was possible. If some countries on the periphery at times slipped from grace and defaulted on their obligations, or let their currency slip, it could only be regarded as a regrettable incident. As the ruling class even in these countries depended on British and European loans and connections, such defaults did not constitute systematic transgression.

After the First War the ideology of this blissful state persisted. Its basis had already been undermined by the loss of economic hegemony by Britain. It was smashed by the Great Depression and finally buried by the Second War. Foreign trade is now subject to direct quantitative regulations which completely overshadow the effects of tariffs. These are an essential counterpart of the State control of domestic economic activities to secure stability. In the case of European countries devastated or weakened by the war they fulfil a further twofold function: they prevent a flight of capital in face of an uncertain future, a flight which would endanger the value of the national currency and thus the basis for orderly reconstruction. And they conserve the scanty foreign exchange holdings for essential imports. As European productive capacity is both weakened and unbalanced; as it has been cut off from its overseas markets and finds it difficult to secure outlets quickly in the face of very great sales resistance (imperfections), it would be intolerable if such foreign exchange as becomes available were wasted on non-essential imports.

It might be argued that the same purpose could be achieved by measures which do not interfere with the 'normal' working of the price-mechanism by changing the distribution of wealth and income. But such measures would have to be very drastic. A wholesale expropriation, or at least complete freezing, of capital assets, which could be sold to indulge in wasteful expenditure, and heroic direct taxation of incomes, would have to be employed.<sup>1</sup> Nor is it certain that if these methods were employed, the private enterprise system could at all function, as it is based on net profit-expectations, i.e. profits after taxes. The perfectionist argument in effect boils down to the proposition that if a Utopian working of the economic system could not be safeguarded, harshest social injustice should be permitted. There is not the slightest chance of

<sup>1</sup> Cf. Chapter 5

drastic action to abolish inequality even in Britain, far less on the Continent. Under these conditions, quantitative regulations, rough and ready though they must be, serve to maintain a tolerable equality in the use of scarce resources and prevent at least the most outrageous inequalities in those countries in which the majority of the population is in favour of this policy.

We have, moreover, come to understand that the readjustment of the balances of payments of countries, like their economic activity, is not subject to predetermination by a higher will. They can be influenced and their instability mitigated by conscious action. We have already seen, when discussing the implications of Bretton Woods,<sup>1</sup> that it is not true, as it is usually assumed, that, given economic resources, there is a set of prices and incomes determined by 'free' markets which will give everyone his 'due.' After the destruction of the mediaeval concept of a 'justum pretium,' of a fair price, decided by some theological or ethical principle, economists tried to prove that the 'free price mechanism' will procure something equally acceptable and harmonious, an 'optimum.'

But prices are increasingly subject to monopoly control. Demand is decisively influenced by the social structure of society, and the care it extends to its weaker members. The new 'balance and harmony' could only be left to be established by the market if the distribution of wealth and income were ethically unimpeachable. They are not.<sup>2</sup> And there are vast differences in the degree to which they differ from what society would regard as satisfactory. Societies differ in their estimate of what should be considered satisfactory; and in each society the concept changes in the passing of time.

Last but not least, it is not true that 'competition' between societies will always determine the 'natural' advantages which these societies possess in producing goods and services. It would be true only if, over and above certain complicated conditions which cannot be discussed here,<sup>3</sup> full employment were always maintained. By causing unemployment a country can always depress its prices by cutting wages and lowering the standard of life of its masses. And, provided the crisis did not lead to a widespread collapse, certain

<sup>1</sup> Cf above, Chapter 1

<sup>2</sup> Or even the least evil. On the implication of high taxes on the working of an unplanned system cf below. The result brought about by an uncontrolled price system would be the best possible only if the consumption of essentials could not be modified by direct intervention (e.g. rationing) without the same unfavourable consequences.

<sup>3</sup> Cf Appendix: 'The Concept of a Dollar Shortage.'

people might not even think the price of this restoration of 'discipline' and 'incentive' too high. Full employment raises awkward problems between the members of different classes. For those who (not unlike the Nazis) confound 'freedom' with 'power to dominate' full employment has few advantages. We have even in this country been subjected to a wearisome campaign against 'inflation' which was nothing but the obverse of 'full employment.' In many European countries there is mounting and desperate unemployment. But unemployment, by keeping wages low, enables manufacturers to compete abroad at advantage. Moreover, sales of other countries to the 'depressed' country diminish. If there were no quantitative restrictions which can be applied against a country pursuing an anti-social and unneighbourly policy, the rest of the trading world would lose reserves to it and would, under certain circumstances,<sup>1</sup> have to follow it in creating unemployment and cutting demand.

Thus even the abolition of quantitative regulations can be safely attempted only between countries which keep fairly well in step in domestic economic and social policy. Tariff agreements are for longish periods and do not possess either the flexibility or the swiftness in action which is needed by war-weakened countries which do not possess ample reserves. If they are dismantled before time the consequence will be to give an undue premium to the most unsocial policy, if not to enforce this policy on all. It is wrong, therefore, to assume (as it is increasingly done in the United States, often with the highest motives) that quantitative controls are an especially obnoxious form of protectionism to home producers, of economic nationalism. These producers have to conform to the general social policy of the 'protectionist' country. In addition, in many cases price-regulation or taxes (e.g. purchase tax) prevents the home producer from making use of the undoubted 'protectionist' effect of the exclusion of his foreign competitor. This is particularly true in cases in which the restrictions are applied to prevent the squandering of scarce resources on unessential uses. Thus quantitative controls, far from being a noxious new form of the old-fashioned protectionism, are essential elements in a system of balanced planning in a single country or group of countries, faced with an unstable world economy. The argument that devaluation

<sup>1</sup> i.e. if the export surplus corresponding to the gain of gold would not create an expansion before the reserves of the deficit country are exhausted.

—which is similar to a uniform tariff on imports combined with a uniform subsidy on exports—would perform the same function as direct regulation without, because it is uniform, 'distorting' the productive structure, and the pattern of trade, is based on the self-same fallacy which asserts that internal 'optimum' is attained by the 'free' working of the price-mechanism. Only if the 'international' distribution of resources were the 'best' possible and unalterable by policy; if prices and wages really expressed real costs; and, finally, if these costs did not show a decreasing tendency as production expanded, could this argument be accepted.

The reasons against a full customs union between countries at different stages of their social and economic development are even stronger. A violent clash would occur. In the industries which use much labour the poorer (low-wage) areas would win, especially in those fields in which—for historical reasons—an unemployed excess capital equipment exists. In other fields, where capital equipment confers a decisive advantage, the poor country would be overwhelmed. In an Anglo-U.S. customs union not much would remain of the British automobile industry, to quote an example. On the other hand, Italian agriculture and perhaps even textile industry would pose awkward problems to Britain. The relationship between labour and capital would suddenly alter. It is difficult to imagine that in the longer run there would be no shift of capital to the poorer area. But the richer, and in the case of a European Union especially Britain, would see a decomposition of their accustomed social structure. The grave position in the textile areas of New England which have to face the Southern competition based on cheap labour is a warning example: the migration from the areas ruined to other localities, in which industry is developing which can maintain the workers at their earlier standard of life, would not be easy when it comes to communities very different in language and customs, and presupposes far-reaching planning if it is not to disrupt the national members of the Union.<sup>1</sup> If migration were permitted all round, the poorer areas would disgorge that surplus of their population which cannot earn at home wages attainable in the formerly richer countries.

It might be said that such equalization of the national incomes of

<sup>1</sup> The Anglo-Scottish Union had exceedingly serious economic consequences on the latter, only later offset by the consequences of the phenomenal success of Scots in England and skilful investment the world over.

the constituent units would be in accordance with the best principles of economic policy. After all readjustments have been accomplished, the region, as a whole, would achieve a higher average productivity. It might then be able to compete with the United States on equal terms. It would not be logical, and might be described as hypocritical, to plead for a more even international distribution of income between European countries as a whole and the United States, and ask the latter for considerable sacrifice, and oppose a similar policy in Europe itself. No one supposes, however, that the United States would consider abolishing her tariffs. Intra-European equalization of income must also be accomplished without devastating shocks. Western Europe as a whole has been considerably impoverished as a result of the war. It suffers from grave lack of capital equipment. On the other hand, its political balance is extremely unstable. Hence any policy, however ultimately beneficial,<sup>1</sup> which would throw out of work capital equipment and result in prolonged unemployment in the richer areas, which can most easily contribute to the re-equipment of the Continent as a whole, must even economically be deplored. Politically it would disrupt the Union before any of its beneficial effects could make themselves felt.

Moreover, a Customs Union would demand a complete reshaping of the whole financial and budgetary system of its members. It amounts to a complete unification of tariffs: a common quasi-political organ (Customs Parliament or a Council) would have to be entrusted with its management. Even if the representatives of the members were not directly elected (thus avoiding the possibility of differences between the government of a member country and its representatives in the common body), political decisions of the first importance would have to be delegated to the common body. Nor would it be easily possible to separate the whole system of domestic indirect taxation from tariff policy, as indirect taxes (especially in more primitive countries where tariffs serve not primarily for their protective effects but as an easy way to collect revenue) represent a similar impost on home-produced goods. Thus an important aspect of social policy will be removed from the competence of the member states. It will be difficult, if not im-

<sup>1</sup> Whether or not it will be beneficial at all depends to a considerable extent on the way it is attempted.



possible, therefore, to keep general fiscal policy out of the hands of the Union. Nor can tariff policy be separated from general social policy: it will partly depend on the tariffs what will be produced within the Union, and once a tariff union has been concluded, and quantitative regulation within the area abandoned, it would be impossible to institute new social reforms in any one of the member countries as this would have similar repercussions on economic activity of that country as the differences in economic and social structure in the period after the Union. Any country which through progressive policies 'gets out of step' would be confronted with grave economic problems.<sup>1-2</sup>

Equally ingenuous are those proposals which envisage the salvation of Western Europe through some monetary union. First of all they attribute far too much importance to the denomination of monetary units. For example, all countries on the Gold Standard are in a monetary union. It does not matter what the currency unit is called, so long as it is interchangeable at will and at fixed rates with other currencies, it can be regarded as the same currency. Transport costs will always cause some small differences in exchange rates between distant localities. It does not matter whether they are expressed in terms of the *price* of the 'foreign currency' or in terms of collection costs in the identical currency. Secondly, they forget that the maintenance of unrestricted payments between different countries will force all of them to follow the policy of the country

<sup>1</sup> The awkward problems which would arise for the British Commonwealth from a Customs Union in Europe have received full attention and do not have to be discussed in detail in this context. It would be impossible to secure the adherence of the Dominions to such a Customs Union as they were not even willing to give up protection against British industry. On the other hand, it would be detrimental to the existence of the Commonwealth to charge duties on their products and permit European goods to enter free of duty. Clearly a double preferential system is needed and/or direct control of imports.

<sup>2</sup> The two alternatives provided by the Havana Charter of I.T.O. would be a 'substantially' 'free trade area' under para 44 or 'preferential agreement for economic development and reconstruction' under para 15 suffer from these drawbacks. In both cases the trade between the countries concluding the agreement must be free (at least any duties charged low) though the members to the agreement retain the right of charging different rates of duties on imports from non-members. It has been suggested that Britain might escape the difficulty by charging 'offsetting' duties on imports which originate outside the 'free trade area' and thus permit a preferential rate for the Commonwealth at least in the case of these 'outside' imports. But this device does not eliminate the objection that Dominion producers would be discriminated against in favour of Europeans and that home producers could no longer be protected against European competition, even when this competition is unfairly advantaged by anti-social policies. Yet it would still run up against the principle of non-discrimination' cherished by the U.S. And, as we shall argue below (pp. 174-192), it would contribute little to the solution of the problem of the relative competitive power of Europe.

which is least progressive and most restrictive. Progressive policies tend to 'increase costs' and 'inflate demand': the poor save less and consume more than the rich. The same thing is true of bold investment policies: they increase demand. Unless the 'creditor' country is willing to lend, the 'debtor' country must fall in with its policy. A cumulative downward spiral might result, spreading unemployment and distress, without benefiting anybody.

If the protagonists of a currency union mean the establishment of a common Central Bank, however, the objection against the proposal would be even stronger. It would not be possible to establish such a Central Bank without giving it far-reaching autonomy, unless the members of the monetary union are fully federated. But this would lead us straight back to the position which obtained prior to 1929, or rather 1914. The bankers would pursue a 'sound' policy of maintaining the stability of the currency in terms of foreign currencies irrespective of the internal consequences of such a policy. Any other task would prove intolerably complicated, and there would be no common political organ which could impose its will on the monetary authority. Without energetic control, however (and often despite it), Central Banks are not apt to pursue social policies. Nor should this be expected of them. They are the guardians of the currency, and could not properly fulfil any other task. In many countries, however, budgets are still unbalanced. Unless the Bank permitted them to go bankrupt, which is hardly conceivable, it would have to come to their aid. There is no reason to believe that the establishment of a currency union would alter in this situation, which has deep-seated social reasons. This would mean that a premium is given to the governments least able to put their house in order.<sup>1</sup> Either all countries would try to snatch such advantage as they could, and thus endanger the common currency, or the more prudent ones would have to carry the others. No union could stand up against the strain and stress which this entails. In the coming period, critical for Europe, moreover, payments outside the union could not be permitted freely, if for no other reason<sup>2</sup> because, as we have already mentioned, we live in a military glacié. The capital flight which would ensue if complete freedom were

<sup>1</sup> A similar problem to that encountered in allocating Marshall Aid.

<sup>2</sup> And there are many other reasons: the desire to evade taxation, the dislike of (progressive) governments would all add to the flight of capital. Nor can Western Europe give up exchange control if it is to correct the balance with the U.S. without serious unemployment.

permitted would certainly entail ruin. But countries in Western Europe, as we have seen, differ considerably in administrative capacity. A unification of exchange control which monetary union would require would, once again, pull the more efficient on to the level of the more backward (or anti-social and lawless). A much more deliberate and slow process of adaptation is needed in Europe before any such far-reaching schemes could be contemplated.

We have seen that behind the high-sounding proposals to 'unite' Europe there lurks either ignorance of the economic and thus social consequences of the plans put forward, or a less ignorant desire to check or at least embarrass more progressive governments—and primarily the British Government—by seemingly ideal schemes in carrying out their programme of social and economic development. At this juncture an effective customs union could only be established on the basis of sharp deflation in this country, and a violent redistribution of income in favour of the well-to-do. Planning would have to be given up. And the position in the relatively richer countries, especially Britain, would undergo a sharp deterioration. Whatever the eventual advantages of such a programme might be in the long run through increased specialization (if the imperfection of markets and the natural inclination of entrepreneurs at the present stage of economic development to monopolistic compacts would in fact lead spontaneously to such specialization) the disastrous short-term consequences through uncertainty and deflation which would probably restrict investment all round, should rule out any such attempt.

Even a general and unplanned suspension of quantitative controls over intra-European trade cannot be contemplated as long as Western European countries pursue such divergent policies as at present, and show such profound differences in their attitude to social and economic problems. Clericalism has triumphed, partly as a reaction to the Communist threat, and partly as a consequence of the Communist tactics in concentrating their attack on the Left-Centre parties, especially on the Social-Democrats. But this triumph let loose in Europe a wave of mass-unemployment and social injustice. It has resulted in a position in which those countries which still maintain the social principles accepted during the war would in a close union have to tolerate their forcible reconversion to

the pre-war economic and social system, which could hardly claim great successes.

Those who advocate sweeping political changes, such as a Federation of Western Europe, hardly ever stop to give detailed explanation as to exactly what sort of economic and social measures the new political organ is supposed to carry out and the consequences on the member countries. They do not specify in detail what sort of re-shaping of industrial organization is to be attempted and by what means. Are existing firms to be expected to change their character and relationship to one another? What system of taxation and subsidies is to be envisaged to help in the transition? The fact that the customs union is not to become effective for some years is no excuse for this levity and ignorance. Once a decision is taken, it will not be easy to protest and impossible, without a formal break, to veto unfavourable action by the Federation. Under present circumstances, the advocates of political reform are in fact protagonists of reaction. The sole credit which might be given to these proposals and movements, is that they call attention to the urgency of the problem and the failure of O.E.E.C. to devise a solution.

Military and political agreement on limited questions of defence there might be. Even with respect to these it is questionable whether substantial contribution of strength can be expected from countries in which a large discontented class would regard outside help in aid of their aspirations not as an armed attack, but as an act of liberation in what they consider their struggle for freedom. The temporary eclipse of the revolutionary threat should not suggest that the political 'equilibrium' reached is anything but precarious, that the internal tension is not, once more, on the increase. Nor could a forcible suppression of this unsettlement through the rise of openly totalitarian regimes represent more than a short-term solution, except in the unlikely event that a parallel development overtook the United States, as otherwise the moral basis of the resistance to Communism would be weakened, and with it the will to material sacrifice. The American friends of Gen. Franco are not steady allies. Nor are they willing to support a long-term drain on their pockets.

These observations seem fully borne out by the experiences in connection with the two schemes which have been promoted: the Benelux Union between Belgium, the Netherlands and Luxemburg, and the projected Franco-Italian Customs Union. They also apply

to the recent change in the attitude of part of the U.S. Government and Congress which represents a regrettable retrogression towards the earlier dogmatism in matters of international economic policy.

The Netherlands maintains a high level of employment and, through a careful combination of control and stimulus combined with an investment programme buttressed by foreign aid, increased productivity by almost 20 per cent since 1946.<sup>1</sup> Belgium, though in a more favourable initial position, has not made any progress in increasing productivity between 1946 and 1948. But its luck in producing scarce necessities, together with a sharply deflationary policy, which was partly responsible for its lack of progress, resulted in export pressure. Had the Netherlands not retained import controls, this pressure would certainly exhaust the Dutch currency reserves and enforce the Belgian policy in Holland. The Netherlands have already been forced to undertake various changes in economic policy, all of which (e.g. the suppression of subsidies to stabilize the price of essentials) tend to depress the standard of life of the mass of the population. The divergence of the tax system, which is much more progressive in the Netherlands, has also made its effect felt. If Marshall Aid had not been voted with relative profusion to the combined area, even that small relaxation of restrictions which has been effected would not have been possible. The preliminary stage of the union had to be postponed for a year, and will become less possible as time passes, unless either of the two main partners were willing to revise its policy drastically. It is improbable that the Belgian adherents of *laissez faire*, strengthened by their recent electoral victory, would make concessions. Though the basic Belgian position, as the above figures show, remains exceedingly unstable, the short term 'success' of their policy (partly explained by capital imports and income derived from pseudo-legal commercial deals) has secured them an undue prestige on the Continent and the U.S.

In the case of the Franco-Italian compact the vitiation of the essential condition of the success of a customs union is even more apparent. The agreement officially encourages conversations between interested private parties to 'avoid disturbances in production and marketing' consequent to the establishment of a customs union. But these 'disturbances' are required if the customs union is to

<sup>1</sup> E.C.E., *Report 1949*, p. 7, Table 4.

become effective, as they constitute the increase in specialization which is the cause of increased productivity. It should have been obvious that in agriculture and even light industry, France and Italy are competitive rather than complementary. Yet the French standard of life is decidedly superior, partly because of the relatively higher degree of industrialization (only 29 as against 44 per cent of the population are dependent on agriculture<sup>1</sup> and output per head in agriculture is more than twice as high as in Italy) and also because of the relative shortage of manpower. While a generous migration policy, combined with a co-ordinated investment plan, might benefit both countries substantially, a brusque 'opening' of frontiers to commodities is likely, as it seems, to lead to a further strengthening of cartels which might benefit the entrepreneurs concerned, but which are likely to add to the pressure on French wages without increasing productivity. Instead of cheapening of goods—if the project were to be implemented—a further increase in profit margins might well take place.

Some, at least, of these considerations lead to the adoption of a much less ambitious programme in framing the Statute of the Council of Europe, which, perhaps, might later be followed by a Council of the Atlantic Pact. Questions of defence are altogether ruled out of its purview. And economic questions are for the moment reserved for O.E.E.C. to avoid overlapping and conflict. As the O.E.E.C. takes its decisions by unanimity, the rights of member countries are safeguarded. A further safeguard is provided by the division of the Council into a governmental element, the Committee of Ministers, in which each State has one vote and on important matters unanimity is required (with the majority of members present). The deliberative organ, the Consultative Assembly, must obtain the consent of the Committee of Ministers before it can discuss a subject. Its membership is appointed by the governments of the member countries. However careful the preparation of the Statute, it is probable that a new parliamentary tradition will grow up through its own practice. In view of the embattled position of Social Democracy in Europe and the isolation of Britain, the personnel of the British Government's representation—in distinction to that of the Opposition—will be of the utmost importance. They are the repositories of all immediate hopes for a

<sup>1</sup> E.C.E., *Report 1949*, p. 225, Table 121.

turn to the better in Europe. The Assembly, whatever its constitutional powers, will perform a most important function as a sounding-board of European public opinion, giving guidance to governments on what problems agreement can be reached on a governmental level. Attempts to decide controversial issues by majority vote would merely undermine its authority and the goodwill which it now undoubtedly possesses. As the ignorance in each of the Western nations about political trends in others remains profound, the former task, however limited, is of the utmost importance. The leadership of progressive opinion will, once more, inevitably fall to the representatives of the British Labour Party, and it is to be hoped that they will rise to the occasion. They will, after so many missed opportunities, once more have a splendid opening to explain to Europe the full meaning of British policy and help to retrieve the cause of social progress. Thorough knowledge of European trends, a burning conviction about the essential function of Western Europe in combining political and economic democracy, great tact, dialectical ability, and powers of eloquence of a high order are required if Social Democracy and the British Government is to regain its initiative and reform the ranks of its foreign allies. Only the highest moral and intellectual qualifications will enable to turn the full tide of deflation, of the return to 'normal' and the fulfilment of the yearning for unemployment which would crown the efforts of those who have forgotten the lesson of the inter-war period. It is questionable whether the British Government realized the importance of the occasion.

## CHAPTER 4

### AMERICAN TRENDS

ONE might have hoped that the practical demonstration of success of the first year of the Marshall Aid would stimulate an, at least tentative, exploration of its extension, both geographically and temporally, as a full solution of our troubles. After all, industrial production in Western Europe increased by almost 10 per cent (including Western Germany over 15 per cent<sup>1</sup>) in one year, and Western Europe as a whole succeeded in cutting the overall deficit by 50 per cent and substantially reducing even the dollar gap in the balance of payments.<sup>2</sup> This success, much beyond expectations, should have strengthened the hands of the Administration and other sponsors of the European Recovery Programme. This hope was disappointed, and for several reasons.

First of all the Communist danger in Europe, which early in 1948 gave rise to a paroxysm of fear, has somewhat abated. In France and Italy the power of the Communists in the Trade Unions is slightly weaker, and the physical power of the Trade Unions themselves has diminished with increased production and stocks. Since the end of 1948 there has been little manifestation of Russian aggression. The so-called American way of life—or rather its least attractive features—has made some headway in Europe, without even causing much domestic trouble. And it has been carried, except perhaps in Germany, without direct American intervention. Marshall Aid was freely flowing, and the improvement in production enabled an increase in the inequality of the distribution of income (and consumption), inevitably associated with decontrol, without a decrease in the absolute standard of life of the masses.

It is, on the whole, difficult to believe in the Macchiavellian subtlety and far-sighted cunning of Russian diplomacy, after its performances at various international conferences. In particular

<sup>1</sup> O.E.E.C. *Report on the Progress of European Recovery*, p. 53.

<sup>2</sup> The Western O.E.E.C. countries reduced their overall deficit from \$6,520 million to \$3,282 million, i.e. by \$3,260 million. To this improvement Britain contributed \$2,160 million, Belgium \$250 million. Only the French deficit increased (by some \$30 million), despite the devaluation. *Ibid.*, Table 31.



their refusal—on *formal* grounds—to participate in, or even explore the detailed possibilities of, the European Recovery Programme, and brusquely prohibiting their satellites to participate, has certainly saved Western Europe from a painful crisis. It is hard to imagine that the European Powers could have produced an agreed programme at Paris—even if it had only contained a hazy outline of the policy envisaged for recovery, accompanied by a much more substantial shopping list—had the U.S.S.R. or any of the ‘orbit’ countries had a voice at Paris. It would be even less easy to picture the passing of a substantial appropriation by Congress if the suspect countries had been its direct or even indirect beneficiaries. No doubt some formula or other could have been found to eliminate unwanted sharing. But time would (and could) have been wasted through the necessary manoeuvres, and public opinion would certainly have been confused.

The Russians completely misjudged the temper and motives of the United States in 1947. Thinking in terms of an impending American depression, they thought they could bring it on by refusing to participate in receiving Marshall Aid. They probably also misjudged the position in those Western areas where the Red Army had not penetrated, and thus could not assure the local Communists a hegemony of armed force. But at that moment the war-time pent-up demand in America was still sufficient, and the main worry of the Administration was to convince Congress that America would not starve or suffer acute inflation as a result of the Marshall Aid.<sup>1</sup> Russian hostility, incidentally, resulted in a decisive expansion in American military expenditure, and these two factors were sufficient to prolong the American high prosperity for eighteen months. In consequence, rapid recovery took place in Europe and the Communists were much weakened. The violent reorganization of the Eastern European Governments, and the concomitant persecution of non-Communists consolidated their opponents in the West. The speed of political and military agreement in the West became even greater than economic consolidation.

The imposition of the Berlin blockade by the Soviet was the culmination of this policy. With its ending and the agreement on a *modus vivendi* in Germany we see—however unjustifiably—the first

<sup>1</sup> The rather generous regulations in respect of off-shore purchases can certainly be attributed to this factor.

and strongest of the emotional props of E.R.P. seriously weakened. The Russians, even if they decided on this change in policy as a result of developments inside their sphere, have certainly found the most effective method to bring about a decomposition of Western solidarity. As in Berlin, they merely have to refrain from overt aggression to put their adversaries into an equivocal position. The achievement of the air-lift is more difficult to reproduce on a non-technical, economic plane in which the agreement among the Western partners is necessarily more shaky.

The second, though hardly as immediate, development weakening the original impetus behind E.R.P. was the growing disappointment at what, despite the success of 1948, appeared to be the failure of Europe of solving the problem of 'viability,' of the re-establishment of a dollar balance without 'wicked practices.' To some extent, as we already mentioned, this was due to the lack of imagination and tactical sense of the European Governments, and more especially of the British. But perhaps it was also due to the growing split between American desires and ideals, for which, comprehensibly, the blame is often shifted on to the foreigner. The theological fanatics of 'multilateralism' made their second bow.<sup>1</sup> It might, perhaps, have been possible, through rational discussion, to dispel some of these

<sup>1</sup> Their attitude is illustrated by Professor F. D. Graham's additional and poetical review of Miss Barbara Ward's restrained book, *The West at Bay in the American Economic Review* (March 1949). Miss Ward, like most thinking Europeans, accepts the view that if a serious deterioration of the Western European standard of life is to be avoided (and thus a grave threat of internal decomposition), some effective means must be found to achieve an economically better co-ordinated Europe. Professor Graham thinks that he can effectively dispose of Miss Ward's argument by saying that both the United States and Japan have gained in industrial competitiveness on Britain in the inter-war period. Hence, he argues, there is no reason to suppose that the creation of a large market, increased standardization and mass production would be essential for the salvation of Europe. The fallacy of this objection is palpable. Professor Graham, who at times held critical views of orthodox theory, argues as if the United States, when producing one type of commodity, would at any moment have to forgo the production of others: i.e. he argues on the basis of static assumptions and full employment. As the United States, except in war and immediate post-war periods, is prone to mass-unemployment, and as it is, in any case, a highly dynamic economic system (even when plagued by unemployment), his arguments can hardly convince except those already convinced. He quotes the example of Japan to show that a country, despite low productivity per head, can be competitive. Thus, he believes, is a sufficient argument to prove that comparative costs 'work' and that Europe should rely on the market mechanism as producing 'optimum results.' A more unfortunate example for what would happen if we were to adopt his nostrums could not have been chosen. The problem of Western Europe is to become competitive without having to lower its standard of life or at least to keep the reduction to a minimum. The attempt might fail. But a large part of the blame will lie with those who, on the basis of implicit assumptions which have nothing to do with reality, conduct campaigns for political action, the consequences of which they do not trouble to investigate and have no imagination to divine.

persistent misapprehensions and contradictions. Unfortunately, the third factor, the decline in American economic activity after November 1948, considerably aggravated the European, especially British, difficulties and thus lent plausibility to earlier United States' prejudices. It also precipitated the usual confusion in American public opinion. This is nothing short of calamitous, as all these problems are deeply charged with emotion because they affect the basic tenets of American ideology and thus are exceedingly difficult to handle.

There is no dispute any longer about the facts of the U.S. position. The President's authoritative *Midyear Economic Report*<sup>1</sup> has, at last, set an end to the acrimonious disputes of the earlier months of 1949. Twice before already U.S. business activity showed signs of hesitancy after the violent inflationary boom of 1946. Both early in 1947 and early in 1948 many competent observers predicted an impending fall in production. In both years these fears were shown unjustified. The vast increase in the export surplus from \$7,799 million in 1946 to \$11,278 million in 1947, the increase in Government expenditure on goods and services from \$28,000 million in 1947 to \$35,500 million in 1948 mainly on account of foreign aid and armaments, and the consequent expansion of private investment to the unparalleled level of \$43,600 million in the fourth quarter of 1948 (as against \$26,500 million in 1946) steadily increased industrial output to a peace-time record of 195 (1935-9=100) in November 1948.

At the turn of the year production began to decline and the rate of fall has accelerated. By June 1949 it had receded, according to preliminary estimates, to 169, or all but 15 per cent. A decline of this magnitude in a relatively short period is certainly exceedingly serious, even if account is taken of the highly seasonal character of American business. In terms of nineteenth-century business cycles it would be characterized as a major depression, though, of course, it does not approach 1929-32. But 1929 was a major catastrophe due to exceptional mismanagement. The drop in the same index between 1937 and 1938 was from 113 to 89, i.e. 24 points or some 21 per cent. Nobody doubted, then, that that was a major downswing.

<sup>1</sup> July 1949. U.S. Government Printing Office. Together with a report, 'The Economic Situation at Midyear 1949,' by the Council of Economic Advisers.

Employment in manufacturing in June 1949 was 1 million below last year, or 6 per cent. This accounts for the increase in unemployment officially to 3.7 million, to which, perhaps, roughly 1 million should be added as escaping statistical observation. Employment, however, which fell continuously since the autumn of 1948, increased slightly in June 1949. Total national income has declined from the peak rate of \$236,000 million p.a. in the fourth quarter of 1948 to below \$221,000 million p.a. in the second quarter of 1949, or by some 6.5 per cent. Factory payrolls, however, fell more steeply. Nevertheless, personal savings increased from 5.1 per cent in 1947 to 10.7 per cent of the disposable income, thus once more confounding the prophets<sup>1</sup>—unfortunately in an unfavourable sense. The tax-concessions decreed in 1948 and favouring high-income classes only explain part of this shift. The fear of instability and the hope of being able to buy more cheaply must have played an important part.

None the less, sales did not decline in anything like this proportion. The explanation must be sought in the heavy liquidation of stocks at all stages of production, which was mainly responsible for the decline in the rate of gross investment from the level of \$43,600 million p.a. in the fourth quarter of 1948 to \$32,400 million p.a. in the second quarter of 1949, or over 20 per cent. The rate of expenditure on plant and equipment only declined by \$500 million p.a. between the second half of 1948 and the first half of 1949. Building construction, while first moving considerably below 1948, by May 1949 almost recovered to that level, mainly as a result of an increase in public building. The value of contracts has even risen above the average of 1948.

Contrary to sensational newspaper reports, prices (other than sensitive raw-material and food prices) have fortunately not fallen substantially, so that there is no immediate danger of a violent cumulative downward spiral. The relative stability of wage rates exerts a dampening influence. The cost-of-living index has only declined 2 per cent from the monthly average for 1948, food being some 4 per cent lower. The miscellaneous items are in fact somewhat higher than in 1948. Wholesale prices have not declined by anything like the proportion indicated by some sensitive prices

<sup>1</sup> Cf e.g. Mr. Colin Clark in the *Oxford Institute of Statistics Bulletin*, 1944. Mr Clark's other attempts to establish immutable statistical laws in respect to highly dynamic problems were not more successful

which received so much publicity. The general index at 154.0 is only down 11 points from its 1948 average, or just over 7 per cent. Food is down from 179.1 to 162.9, but commodities, other than farm products and food, have only declined from 151.0 to 145.0.<sup>1</sup>

While projected investment still remains at a high level, new orders for durable goods have fallen by over 30 per cent from the peak reached in 1948, iron, steel and products being the hardest hit. Unfilled orders have also declined substantially. As profits had to bear the first brunt of readjustment (falling from an annual rate of \$21,200 million (after taxes) to \$15,300 million in the period) it would, to say the least, be optimistic to assume that the trend will reverse itself without some Government action, especially as the U.S. psychology will not regard the rigidity of prices (due to the new rigidity of wages) as a favourable indication for the future.

This turn of events necessarily had serious effects on European recovery, trembling on the brink despite its initial success, and itself menaced by deflation and a threatening decline in investment and production. According to the most sanctified of orthodox canons, a country gaining gold as a result of a favourable balance of trade should experience an automatic expansion, thus contributing its share to 'readjustment.' If the 'surplus' country suffers from an acute deflation, the process of readjustment as conceived by the classical school of economists is completely vitiated. Instead of a see-saw movement around a fixed level of total real income in the world system as a whole, a competitive up- and down-swing of business activity, affecting them all, will be experienced which will render the task of the deficit countries extremely difficult.<sup>2</sup> The poorer and weaker countries at the periphery of the world economy are bound to feel the blast of the change in climate at the centre with redoubled force. A readjustment enforced without planned expansion might result in competitive cutting of the standard of life of all, without helping anyone. Each cut in costs imposed by deflation represents *ipso facto* one of demand through a shrinking of income and of employment. Hence deflation in a dominant country will be

<sup>1</sup> All these comparisons are between the monthly average of 1948 and May 1949.

<sup>2</sup> My essay, 'The International Implications of Full Employment,' *op cit.* In view of the only too normal pattern of the United States downturn, the loud protests of the United States defenders of Bretton Woods who insisted that there was no reason to anticipate that the slump would start in the United States despite the fact that she had suffered no war damage and her national income per head was far higher than anywhere else, appear tragicomic.

followed, or even anticipated, by the others unless they are willing and able to suffer a diminution of their gold reserves until the ever-increasing losses stop any further shrinkage in demand. These competitive cuts in prices by deflation or devaluation, far from increasing demand and turnover, accelerate the speed of the downward slide. It is this competitive beggar-my-neighbour policy, as futile as it is dangerous, which is now once more advocated by the conservative experts of the U.S. Treasury and the Federal Reserve Bank—despite all the experiences of 1929. Yet, for a country with weak reserves, it might be difficult to stand out against a strong deflationary wave.<sup>1</sup> It is for the strongest country, the United States, to take measures to stop the rot.<sup>2</sup> It seems extraordinary that the immediate and violent consequences of even a relatively slight American recession on countries still fully employed should excite such astonishment. The whole dispute of Bretton Woods concentrated round this point. It is comprehensible that interested parties should use the British difficulties to run a campaign against the social and economic policy of the Labour Government. What is less evident is the ease with which they could gain even reputable support.

It is one of the strangest phenomena that the very economists who voice their steadfast belief in the efficacy of the see-saw machine of readjustment are most to blame for its breakdown. Whenever there is a chance of the export-surplus and gold-gaining country doing its bit towards readjustment, loud cries of warning against inflation are heard, and the creditor is seen to take hasty action to check its demand from rising further than its productive capacity. Thus the natural way of promoting import surpluses is barred in the name of self-righteous monetary soundness. It would be interesting to analyse the psychological motives which at one and the same time insist on Europe ceasing to rely on borrowing or aid, i.e. on paying for imports by current exports including services ('viability'), irrespective of political and moral considerations,<sup>3</sup> and nevertheless

<sup>1</sup> This does not mean that single countries, e.g. Britain, may not have over-expanded at the same time. It merely means that in a generally deflationary situation, when unemployment in the whole system is increasing, attention must be concentrated on stopping the decline. The readjustment of the deficit country must be co-ordinated with re-expansion elsewhere.

<sup>2</sup> Cf. the Report of the Statutory Advisory Council of the President on International Economic Policy, June 1949. As reported in the *Financial Times*, July 12, 1949.

<sup>3</sup> Cf. however, above p. 14, on the advisability of maintaining a surplus in the U.S. balance of payments from the point of view of a better international distribution of income and wealth.

conduct a violent campaign against the maintenance of conditions in the U.S., i.e. a slight excess of monetary demand over home supply, which are necessary if Europe is to pay.<sup>1</sup>

It is, unfortunately, impossible to divorce foreign and domestic economic policy, and the desiderata of foreign policy seem to clash with vital needs of the home economic system. A slight inflationary tension at home inevitably upsets the 'normal' working of the free-market system as it gives more power to the Trade Unions in their negotiations and consequently frightens the entrepreneurial class at the threat of an invasion by labour into the rights of management. There is certainly also some truth in the assertion that in the absence of some unemployment and its counterpart, the competitive pressure for sales, efficiency and discipline suffer, and a cumulative inflationary spiral is prone to start. A substitution of other, social or governmental, devices to attain these vital ends would come up against the resistance to 'totalitarian' encroachment into the 'American way of life.' This was the fate of Mr. Truman's earlier, rather modest requests for power to control the inflationary pressure emanating from the pent-up demand which accumulated during the war. The distaste of the managerial class for any State intervention is certainly comprehensible, however beneficial it may be in the short run even for them. It opens up a vista of a society in which their confidence in the Government is no longer the ultimate arbiter of economic destiny. To prevent this they are quite rational in opposing policies which might mitigate depressions, i.e. their own losses. What is certainly less understandable, though tolerably certain, is that this attitude is shared by wide circles in the U.S. whose *raison d'être* would not be threatened by a positive Government policy.<sup>2</sup>

<sup>1</sup> Cf. below, p. 89, however, on the difficulties facing European exporters even if favourable general conditions obtain in the U.S.

<sup>2</sup> The domestic sociological aspects of full employment cannot be investigated in this context. Cf. the brilliant article by M. Kalecki, 'The political aspects of full employment,' *Political Quarterly*, 1943. Domestic policy to stabilize employment, e.g. redistributive taxation and social services, or government investment, are perhaps even more objectionable than a foreign aid programme. The former will be opposed because of their implication on internal affairs, while the latter only incur hostility for their financial consequences. It is questionable, however, whether full employment is really in the interest of the entrepreneurial classes. True enough, risks are diminished. But the worry about supplies, especially labour, the accumulation of work, tends to offset this relief. The orthodox assumption that the entrepreneur never prefers leisure to work, even at a loss of income, seems based on a singularly inept psychology. Moreover, in the present monopolistic organization of industry, profits will probably be lower at full employment than with some unemployment. The increase in costs due to a fuller utilization of (less suitable) capital equipment and labour, in many cases, cannot be passed on to the consumer. It might, therefore, be suspected that even from

There are various interesting psychological explanations for the ease with which adherents to the principles of 'sound' finance can be recruited even among those who suffer from the policies they advocate. *Bona fide* ignorance is certainly involved. It is difficult for most to differentiate between the financial affairs of the individual and the State. One must not forget that even President Roosevelt in his campaign against Hoover made use of this misapprehension. And when he learned better, some of the most progressive of his early advisers deserted him on this issue.<sup>1</sup> It is, perhaps, not uninteresting to note that the first progressive economist to be elected into the U.S. Senate, Professor Paul Douglas, in his maiden performance demanded a cut in Government expenditure at a time of slipping business activity. Equally impressive for the outsider is the success with which pleas for the need of State intervention in favour of maintaining effective demand can be dismissed or effectively weakened by reference to the 'American way of life' while measures against monetary expansion are not as strongly opposed.

These fears and prejudices were much more prevalent in the United States than even in Britain. They led to the almost complete emasculation of the Full Employment Bill, sponsored by Senator Wagner, which was, significantly enough, enacted under the title of 'Employment Act,' with the subversive word 'full' omitted. A further hardly less important factor in shaping American attitudes and policy is the fact that no administration would admit at a date sufficiently early for action that business activity is slumping. This might be taken as proof of its own failure even by its own adherents, however much they would dispute, in good times, the older view that business 'when left alone' is *ipso facto* able to provide maximum (desirable) employment. Even if they do not subscribe to the view that any 'measure' to remedy this 'failure' must be negative: i.e. the reduction of government expenditure and taxation, they will be afraid to aggravate the decline. Thus the first reaction is always to deny the existence of a 'crisis' or 'slump.' The speed with which

economic, as contrasted with political reasons, entrepreneurs—and professors—prefer a certain amount of unemployment. Even such 'slight,' 5 to 10 per cent, unemployment in the United States, however, 'restoring flexibility' might well prove fatal to Europe if concerted action is not taken to mitigate its consequences on the balance of payments.

<sup>1</sup> Only to rejoin him when deficit financing started in earnest, at the beginning of the war—but war-economics, it seems, has completely different ethical and technical criteria from peace-economics—apart from its quantitative and teleological aspects (hence also the rôle of compulsion)—for many, otherwise intelligent, observers.



President Roosevelt and now President Truman faced the decline differs remarkably from President Hoover's years of search for a recovery round the corner.

There were, however, certain fortuitous reasons for the apparent reluctance of the U.S. Administration to recognize the turn of the trend at even an earlier date. One of these originates in the miscarriage of Mr. Truman's attempt, already mentioned, after his spectacular victory in 1948, to fortify his powers against the possible recurrence of inflation. His programme was almost entirely expansionist. A housing measure to remedy the shocking living conditions of the poorer classes in most urban areas of the U.S., a new health service scheme and other social services as well as the expansion of already existing benefits were the backbone of his programme, which he carried at the polls against all expectations, and against the bitter antagonism of the previous Congress. The consequent increase of Government expenditure, together with the heavy armaments and foreign-aid programme, would certainly increase total demand even if it were financed out of taxation. Some, if not most, of the proposed increase in taxes would tend to reduce not so much spending as saving, because it was to be collected from the better-to-do. Moreover, it was thought that this increase in demand would induce additional private investment, thus further swelling probable outlay. Even if the initial projects were relatively modest, at a certain point the economy would begin to feel the tension.

The fear of inflation was further accentuated by the sympathetic, if largely erroneous, apprehension that a U.S. expansion and rise in prices would further aggravate the problems of Western Europe: it is particularly regrettable that this misinterpretation of the position was strengthened by the British Government, which might well have had the quantitative aspects of this all-important problem<sup>1</sup> investigated at a sufficiently early stage. The importance of the terms as distinct from the volume of trade were exaggerated and insufficient attention was paid to the fact that Europe's (and Britain's) exports were likely to suffer severely from a decline in world income. This was yet another consequence of the disregard of the large and increasing imperfections of the markets for manu-

<sup>1</sup> To this particular aspect of the failure of the British planning staff, and its consequences on bulk purchase policy, we shall return presently.

factures in which the effectiveness of price-competition is vastly exaggerated. It is true that the sudden decontrol of prices in the U.S. in 1946 and the consequent violent speculative boom in primary products represented a grave burden to Europe. But this was the consequence of the exceptional need for primary supplies, including even coal, from America due partly to war damage and the disorganization of production. With the recovery of European production and the diversion of demand for primary commodities towards non-dollar sources the rôle of the U.S. as a source of these supplies diminished.<sup>1</sup> At the same time she regained her importance as the largest market for (mainly tropical) primary commodities.

Moreover, the American internal primary markets were no longer unprotected from those sudden price-falls which characterized them prior to Mr. Roosevelt's reforms. However much she opposed restrictive compacts, bulk-purchase and other Governmental measures of stabilization generally, the U.S. has a comprehensive agricultural price support system. No similar schemes exist in respect to her primary imports. A depression, therefore, is not merely likely to depress the volume of imports but also their price. So long as the world is in need of U.S. primary products, a depression is more likely to aggravate the dollar balance now than before the war, especially as in a number of potential sterling area exports, of which rubber is the most important, the U.S. has become more rather than less self-sufficient and maintains this self-sufficiency by deliberate measures.<sup>2</sup> The renaissance of orthodox economic prejudice would, in the case, at any rate of foreign supplies, render the U.S. Government less inclined to accelerate counter-cyclical

<sup>1</sup> As we shall see, this fact accounts to some extent for the discrepancy of prices between the sterling and dollar area. The expansion of United States agriculture somewhat mitigated the consequences of the decline of agricultural production on Europe's terms of trade. It might be added that the Marshall Plan, *ceteris paribus*, maintained agricultural prices by permitting Europe to buy in America. If, of course, the United States would burn or feed wheat to livestock domestically, the cessation of aid would not even have the offsetting consequence of turning the terms of trade in favour of Europe. If, on the other hand, the United States dumped its agricultural surpluses in foreign markets, Europe's terms of trade would improve. Whether that would in fact represent a net gain in the long run is much more questionable, the ruin of primary markets would impoverish the customers of Europe. In view of the difficulties involved in the consequent shifts of demand and production, it might be feared that some of Europe's 'gain' would have to be taken in the form of unwanted leisure, i.e. unemployment, as in the 1930s.

<sup>2</sup> This self-sufficiency has been buttressed by deliberate protective measures. Synthetic rubber consumption is stimulated by a quota regulation. The tin-smelter erected in Texas to protect war supplies has also been retained in production by 'restrictive' practices. Further 'artificial intervention' is practised with respect to merchant shipping.

measures such as stockpiling. 'Losses' might be incurred. And expenditure must be kept down. Nor could the 'free market forces' be relied on to restore equilibrium without grave troubles outside the U.S.<sup>1</sup> Hence a decline due to de-stocking might have devastating immediate effects on the supply of dollars. As the sterling area is a main source of such supplies it would experience a violent fall in exports. This certainly could not be attributed to either 'inflation' or 'reckless social expenditure.' Indeed, the failure to institute 'artificial' support schemes for these primary products would, in fact, diminish dollar supplies.

As far as direct European exports to America are concerned, it is not probable that American demand would expand sufficiently if they were made generally (in contrast to *selectively*) cheaper, e.g. by devaluation, so as to more than offset the consequent fall in dollar prices, especially if Europe tried to force the pace during the active downward phase of a depression.<sup>2</sup> It is, not mainly, a simple question of price. The American markets for e.g. British products are mostly limited because outlets to, and knowledge on the part of, the final consumer in the Middle and Far West of America are lacking. Even in the Eastern Seaboard they are little known. It is the imperfection of markets, the consequences of U.S. marketing techniques, which limit European sales apart from U.S. protectionism. To open up a market represents a heavy capital investment, and this capital investment would only be practicable if the extreme uncertainties consequent on the vagaries of American customs procedure and tariff policy could be eliminated.<sup>3</sup> Even then it seems unlikely that the typical small firm in Western Europe could do much. If it successfully establishes itself in the U.S. market, however, it is more likely than not to emigrate completely. The

<sup>1</sup> In case of a sharp devaluation of foreign currencies the possible increase in supply consequent on a speculative increase in foreign prices might even cause a further, temporary, fall in total dollar proceeds, as demand is not likely to increase with a declining dollar price. There is no appreciable competitive supply of most of these commodities available in the Western Hemisphere which could be displaced by increased non-dollar supplies. In any case, even a threatened displacement (e.g. of wool) would result in violent U.S. reactions.

<sup>2</sup> Nor must it be forgotten that the import content of exports to the U.S. is rather higher than average, especially if U.S. sales costs are included. The price of exports would therefore not 'benefit' proportionally by depreciation.

<sup>3</sup> The importance of customs procedure is shown by the fact that while average duty collected on dutiable commodities has decreased from 35 per cent in 1938 to 25.5 per cent in 1946, 19.4 per cent in 1947 and 13.7 per cent in 1948, the volume of *dutiable* imports did not increase more than could be expected from the increase in non-American production and in the U.S. national income.

attraction of the U.S. market and the importance of direct contacts with customers are more important than the possible advantages of production (lower wages) elsewhere.<sup>1</sup> The larger firms have their own factories or are allied to American factories and will not compete there.

A collective (trade or state) financed sales campaign and the establishment of collective representation of British or even European industry in the U.S. is a much more hopeful method. If successful, however, it would come up against vehement hostility, especially in a period of declining prices and output. These observations would seem to hold good for any situation in which there is no over-employment, in which, that is, U.S. demand does not increase at a rate faster than U.S. productive capacity, or other measures are not taken to canalize U.S. demand towards European products.

It might, theoretically, be possible to displace American goods sufficiently to obtain dollars in a 'triangular' fashion in third markets. In practice it is not possible to do so in the short run to any considerable extent, as supplies now obtained in the United States are either not available elsewhere or, if available, are severely handicapped by market imperfections (taste, etc.), in favour of the U.S. products. Nor is it evident that piecemeal devaluation and deflation necessary to displace the U.S. by straight price competition will result in achieving the greatest possible real income for Europe. The consequent losses might amount to a multiple of the 'gain' which might conceivably flow from buying in the 'cheapest'—the American—market. A general and sharp devaluation of all non-dollar currencies would not be subject to the latter objection, at any rate in the longer run. It is, however, difficult to arrange and would, if successful, meet United States opposition. There are, moreover, good, domestic, reasons in the case of Britain against this course of action.

The U.S. advocates of devaluation seem to be led by ideological and political rather than economic motives. They hope that devaluation will be the first step in a dismantling of the 'Welfare State' and planning. No doubt they would be the first to protest against increased 'unfair' British competition if their advice were accepted.

Unfortunately the slackening of the domestic demand for U.S.

<sup>1</sup> Cf. U.S. attempts made to capture French female fashion industries.

products is likely to increase the resistance of short-sighted vested interests against either accepting competitive non-dollar imports from Europe, or tolerating discrimination against American exports.<sup>1</sup> The recrudescence, on the top of all this, of the resistance against deficit financing, especially the financing of foreign aid, while revenue is declining, closes the last escape route from this *impasse*. The fact that U.S. sales are limited only by the supply of dollars and that 'competition' for these dollars does not increase their total supply during an American slump is still not realized.

The overwhelming majority of the non-Communist world consists of countries which have no sizeable dollar earnings or which spend such dollars as they have on U.S. supplies. How much they buy in the U.S. is therefore determined by their dollar earnings. They cannot increase their purchases in the U.S. beyond that level, however 'cheap' American supplies may be. If they want to buy foreign goods (mainly manufactures) beyond the level permitted by their dollar earnings (even of the same general type as those which they buy from the U.S.) they can only buy these from countries to which they can sell and earn foreign exchange, i.e. Britain and Europe. Moreover, it is more important for them to sell at relatively attractive prices than to snatch transitory profits by buying cheaply because they must be well aware of the fact that the inevitable and ultimate consequence of the transitory gain by 'buying cheap' will be that their export prices will also be cut. This is shown by the successful conclusion of a five-year agreement with Argentina which circumvents the dollar shortage.<sup>2</sup>

It might be objected that they will refuse to buy the same goods

<sup>1</sup> E.g. in the immediate post-war period a quota regulation was enforced on Swiss watch exports to the U.S. Attempts to restrict Australian wool exports were all but successful. Various 'surplus' commodities are being liquidated through the Marshall Aid and 'offshore' purchases—so important in financing British imports from Canada—are restricted. Congress barely failed to earmark further large parts of the aid for the purpose of buying up American surpluses irrespective of European needs. A bitter dispute developed about the reservation of Marshall Aid shipments for the U.S. merchant marine. Tied loans, moreover, are reserving overseas markets for heavy equipment for U.S. firms. Cf. my articles on the I.T.O. Charter and the Geneva Agreement on Tariffs in the *Oxford Institute of Statistics Bulletin*, 1946 and 1947. The operation of 'comparative costs' is further impeded and pressure abroad increased by the farm support programme which might eventually promote dumping of agricultural surpluses. Cf. above.

<sup>2</sup> The reported protest of the U.S. against this agreement shows a regrettable lapse back to the Hull-Clayton theology. Nothing that Britain has done will diminish Argentinian purchases in the U.S. On the other hand, no dollars are available to finance Argentinian purchases in the U.S. except by cutting British purchases. The Marshall Plan recognized that Britain would have to expand her sales to South America.

'dearer' elsewhere than they can obtain them in the U.S. But these countries cannot obtain all the goods they desire from the U.S. (over and above their dollar earnings), for they have no dollars. An attempt to extract dollars from their trading partners—as, for example, Belgium has tried—would merely result in retaliatory decrease of their exports, for no country has 'surplus' dollars. It is the dollar shortage which forces a decrease of U.S. exports and not the 'wickedness' of 'planners.' The *only* question which is open is *whose* purchases from the U.S. will be reduced. This question can be answered by planned distribution of available dollars (by those countries having relatively greater supply, paying for some of their imports from their less favoured partners in dollars) or by an internecine struggle for dollars through competitive deflation and devaluation, hoping to achieve extra-U.S. surpluses convertible into dollars.<sup>1</sup> In the latter case they might try to snatch transitory gains by insisting on being paid in dollars in order to buy in the U.S. The consequence inevitably will be a further narrowing of trade. Thus gains obtained by buying 'cheap' will fade as every country will find itself unable to export. Their own prices will begin to drop either because of an enforced deflation in Britain (and Europe) or because the value of their currency, in terms of sterling (or other European currencies) has appreciated. The U.S. contagion will spread. On the other hand, by concluding reciprocal purchase agreements and maintaining a tolerably stable price-level, the consequences of the U.S. slump can be restricted to the losses suffered by not being able to sell to U.S. at better prices and in larger quantity. Even this will be inconvenient and might be extremely damaging; but the real catastrophe of a multiple shrinking of foreign trade could be avoided. There is—it should be repeated—all the differences in the world, however, between a sudden, sharp and general devaluation of most, if not all, non-dollar currencies, and a creeping piecemeal attempt to extricate dollars from other non-dollar areas. Apart from everything else, the latter method gives time for United States exporters to readjust themselves to the new position.

If we bear this in mind the clamour for European devaluations to defend their 'third' markets against threatening U.S. export competi-

<sup>1</sup> The loss of gold by Britain of £12·2 million to Belgium, £5·6 million to Switzerland, and £4·7 million to Germany suggests that too little attention has been paid in the flush of recovery of 1948 to these questions.

tion during a decline in U.S. business activity is difficult to understand (with the exception of those few markets which still have dollar surpluses, or in the case of which controls work so badly that dollars are used to buy non-essential goods or goods obtainable in other markets). There is not the slightest reason to doubt that even a partial convertibility of European currencies into dollars would now cause a wholesale restriction on European trade, especially if the American deflation continues. The interconvertibility of currencies in Europe is practicable as soon as a greater monetary and financial unification has taken place in Europe. Intra-European payments and trade should be encouraged. But this can be done most effectively by a tentative *relaxation of quantitative restrictions*. Even that would have to be accompanied by a much closer co-ordination of investment and general economic policies than has hitherto been the case. Dollar convertibility can be restored—even partially—only after European reconstruction has succeeded in diminishing the inequality of opportunity between the two continents, and the U.S. regained her equilibrium. Until then a sane course would be to advocate a strengthening of controls.

The problem of the third countries is exactly analogous to that of Britain. The import requirements from the U.S. at a tolerable standard of life are far higher than dollar earnings. In the short run the 'free' play of the price mechanism will not make available non-dollar supplies in sufficient quantity to take the place of goods now supplied by America. This is as much true of machinery and manufactures, which South America needs, as it is of the food and raw materials we need. The decrease in the standard of life needed to match U.S. competition without discrimination might be so drastic as to be ruled out for political reasons. Without a comprehensive settlement and a reversal of the trend in the United States, even a simultaneous and general devaluation would not provide a satisfactory solution in the short run, because of its very doubtful immediate effect on direct dollar earnings. It is, as we shall see, especially in the case of Britain, only the shortcomings of exchange and other controls which counsel the course of even general devaluation.<sup>1</sup>

<sup>1</sup> Cf. my paper 'Should Sterling be Devalued?' in the *Bulletin* of the Oxford University Institute of Statistics, 1949. A devaluation of sterling might have to be undertaken as a result of the speculative attack much encouraged by loose talk in the U.S. (including official circles) which, given the shortcomings of British—and even more European—exchange control, results in heavy capital flight. There is no reason to hope that it will 'cure' the dollar

The decline in American business activity, therefore, even though 'slight' in terms of the employment and output fluctuations experienced in that country since 1929, must have devastating results abroad because of its shocklike aggravation of the basic long-term disequilibrium due to the faster increase in productivity which we have already discussed, and because of the sudden fall in purchases of raw-materials. The fear of a deflationary bias being imparted to the world economy seems by the U.S., despite violent assertions to the contrary, only too much justified.

Nor can the view be accepted that private U.S. investment, at rates of return which could possibly attract American private investors, could restore balance. It involves ignorance of the mechanism and of the limits of private foreign investment, and of the quantitative aspects of the problem. Private investment necessarily demands some security. This security involves not merely security from the risk of a transfer crisis which itself is a function of the policy, i.e. stability of the creditor country—in this case the United States—but also one of risk of individual default. The former is already formidable, and since it has become acutely patent during the Great Depression, it has prevented any substantial non-Government guaranteed foreign lending. But even the usual 'lender's' risk is a serious obstacle: there would have to be private concerns of sufficient strength available willing to borrow. The order of magnitude of the capital flow required even to maintain the present relationship between capital intensity in the United States and elsewhere is of formidable proportions. As we have seen, we face in this respect an unprecedented situation. Such strong private firms outside the United States which could undertake borrowing at the required pace do not exist, for the investment capacity in the United States is so enormous relative to the existing capital stock elsewhere that private borrowing of this character, as in Germany after 1924, would soon involve the borrowers in ruin. The limits to direct American investment abroad are perhaps less

crisis, it might even aggravate it. It would be a costly defence measure against a speculative attack which the exchange control could not hold. A general devaluation of European currencies, however, is probably unavoidable, in any case, as a *long run* measure in conjunction with a comprehensive scheme to settle the unbalance between Europe and the Western Hemisphere. The short- and long-term aspects of devaluation are unfortunately not distinguished in most discussions. Cf., however, below on the domestic aspect of devaluation, especially in view of the profit inflation in Britain.



narrow, if the political risk is disregarded.<sup>1</sup> But a rate of investment sufficient to equalize capital intensities and incidentally ease the dollar problem would seem to involve, because of the concentration of wealth in the U.S., the passing into U.S. absentee ownership of the most important industrial installations of the world. Foreign countries would be burdened with a transfer problem which could under no conceivable circumstances be solved. The only question would be what sort of economic and social convulsion would be caused in the process of default. No charter, no guarantee, would stand up against the social and political tension generated. It is questionable, indeed, whether the debt obligations already undertaken can be fulfilled in an orderly manner. According to official estimates,<sup>2</sup> the various post-war settlements involve payments of about \$450 million p.a. after 1951 to the U.S. Together with post-war loans and the income from private investments (\$1,263 million in 1948), the total might well increase above \$2,000 million. An unprecedented change in the U.S. balance of payments is required to carry this burden.

The impression was created, first at the time of the grant of the U.S. loan to Britain, and repeated at the time of the passing of the Marshall Aid Programme, that 'this would be positively the last measure of aid.' We have seen in an earlier chapter that the disequilibrium between the U.S. and Western Europe is of a deep-seated dynamic character, which once-for-all grants, even if stretched over a period of a few years, cannot overcome. A depression in the U.S. or even the slackening of the growth of internal demand below the possible rate of expansion of her productive capacity would certainly aggravate the basic long-term disequilibrium. But it should not be confounded with it. The disappearance of U.S. unemployment and selling pressure would not necessarily cure the problem of Europe.

A glance at the relative investment performance and prospects in the United States and Europe respectively—despite Marshall Aid—should have taught people to be cautious and face facts. The United States' rate of current industrial investment is roughly three times higher per worker than that of Britain. The other European states' investment was in most cases a fraction of that of Britain, despite

<sup>1</sup> Direct investment abroad amounted to \$1,312 m in 1948, mainly in oilfields. They could hardly be said to contribute to the solution of the problem of Western Europe.

<sup>2</sup> International Transactions of the U.S. during the war.

their tremendous effort and U.S. help. Under certain not improbable circumstances this discrepancy might lead to a depression of the European standard of life, if either European progress were not speeded up, or measures taken to isolate Europe from the effects of this process. It was this problem the Marshall Plan was to remedy. The advice now given to Europe to 'accept the inevitable,' adjust herself to the position created by the decline in U.S. business activity, to lower her standard of life and to undergo prolonged unemployment in order to achieve 'balance in her payments' is a denial of the essence of the Marshall Programme. It is to be hoped that President Truman's enlightened views would prevail over this short-sighted attempt to destroy the first fruits of the collaboration in the West initiated by the European Recovery Programme.

## CHAPTER 5

### BRITAIN AND THE PROBLEM OF WESTERN EUROPEAN PLANNING

THE renewed, and obviously unexpected, severe loss of gold reserves in the second quarter of 1949, and the defensive measures devised at short notice, bearing too obviously the imprint of an emergency, have, much like the fuel and exchange crises of 1947, once more led to widespread charges that a planned economy and controls cannot work. Not only in Britain, but in the United States and in Continental Europe, a determined effort is made to use this opportunity to smash the experiment of combining political freedom with economic democracy, on which the British Labour Government has embarked. We are exhorted to return to the uncontrolled sway of the price-mechanism, abandon 'artificial' props, cease to live beyond our means, abandon the stabilization of incomes, cut Government expenditure, reduce direct taxation, let the rate of interest play its old rôle, and devalue the pound. The whole conception of a balanced social system is in danger of succumbing—and for the wrong reasons.

In economic and social policy the British Government has become almost completely isolated. Military compacts and political engagements should not lead anyone to conclude that there is anything approaching full agreement on these matters between the main O.E.E.C. countries, the U.S. and Britain; only in Scandinavia and Holland can the Labour Government hope for co-operation in a policy of controlled expansion. Dwindling gold reserves inevitably weaken the bargaining position of a government. There is a grave danger that it will be forced in domestic matters to fall in with policies which it had steadily and rightly opposed. Moreover, the immediate exchange difficulties might well obscure the nature of the more fundamental long-term problem of Western European economic relations with the U.S., with serious consequences for the future.

Such an outcome of the crisis would be lamentable not merely from a British, but also from a general Western point of view. It must

not be forgotten that during the first year of Marshall Aid, Britain achieved something like overall balance in her foreign transactions. The dollar aid was matched by unrequited exports of one sort or another.<sup>1</sup> A one-sided approach to the present exchange crisis, either by a sharp dose of deflation, or even by devaluation, would exert a sharp pressure on the position of those countries in Europe which now bask in self-righteousness, having already undertaken restrictions, and suffering from heavy unemployment. It might be worth while to recall the startling change in the position of the gold block, of which Belgium was a member, after Britain left the gold standard in 1931. The tone of superior wisdom about the need for deflation, about the British exchange difficulties, about the danger of an inflationary collapse of Britain, soon changed into pained dismay at the blast of competition and loss of markets. The serious social and political consequences of that crisis in Continental Europe and the whole world should be a warning against trying to escape from the present predicament by similar policies. We should firmly bear in mind that the British economic balance of 1948 and the first quarter of 1949 was not upset by a change in British policy.

A sudden worsening in the balance of trade of a country does not necessarily prove the need for a deflation, i.e. for a cut in spending power, in that country *if* other countries at the same time suffer from unemployment. Its unfavourable balance of trade might well be the consequence of the decline elsewhere. In that case it should certainly not be tackled by further doses of deflation or by devaluation by the country which has experienced the deficit, but by countering the fall of employment and income which has occurred elsewhere.

Unlike some British commentators, who seem to delight in convicting the Government of reckless social extravagance even at moments when delicate international negotiations are in progress which might be unfavourably influenced by such attacks, President Truman, as we have seen, has recognized the problems created abroad by the decline in U.S. business activity. Unfortunately, this recognition does not seem to have dawned even on all parts of his Administration. Some have even seriously aggravated the problems which the British Government will have to solve by their public discussion of the need for, and possibility of, an early devaluation of

<sup>1</sup> Cf. Table VII, p. 25, and below, pp. 113-121.

sterling. Nor can anyone be certain that speedy action can be obtained from Congress, beset as it is by so many and so contradictory pressures.

This does not mean, let us anticipate, that no action on the part of Britain is required. One-sided action in a deflationary, restrictive sense, however, unaccompanied by measures to secure expansion in those countries which at one and the same time suffer from unemployment and show an excess of exports, might well induce a self-inflammatory, cumulative downward slump which would contribute nothing to the re-establishment of a balance in the world economic system and might exact a high price from the Western World.

Nor does it mean that the Government could and should not have anticipated a worsening of the international economic position. Alternative plans envisaging a defence of the gold reserve, to be put into effect in a smooth and elastic manner, ought to have been prepared. Consultations with the rest of the sterling area should have been continuous. This would also have strengthened the hand of the Government in its efforts to persuade other countries, especially the U.S., in elaborating a co-ordinated policy to safeguard the economic position of the West.

It would, moreover, be unjust and shortsighted to blame others exclusively for the invidious position in which the British Government finds itself. Nor is there any chance of an improvement, of a constructive and social solution of the problem of the West, if the British Labour Party and the Government do not re-examine certain of the principles and the administration of their domestic and foreign economic policy. They have failed to use their political prestige and influence after their electoral victory in furthering the progressive cause in Europe. They failed to secure effective allies for the reorganization of Western Europe, when all those in Europe who were convinced that a return to the pre-war social system could provide no solution looked to them for a lead. Their comprehensible eagerness to tackle domestic problems has led to a neglect of foreign problems. The dependence of Britain on economic developments abroad does not permit such insularity. Social democracy cannot be established securely in a single country only, when that country is Britain.

The present isolation of the Labour Government in Europe is a

proof of failure. It is not sufficient to claim that this outcome is the inevitable consequence of political and economic factors over which the British Government had no influence. Admittedly the position at the moment of their accession to power was extremely difficult. The rift between the East and West had begun, and was developing rapidly. We have already discussed its impact on the problems of a Western Union. It was to overshadow policy in all other directions and determine the political position in almost every continental country. Moreover, a great many decisions shaping the post-war position in Europe had been taken under Mr. Churchill and led to consequences which were not easy to reverse. The Anglo-French disagreements were at an acute stage. The plans for the administration of Germany were already in operation. In Greece and Italy a definite British policy had been initiated. Nevertheless, the question might be legitimately asked whether in many detailed questions a new initiative could not have been taken after the great electoral victory, and, perhaps even more, whether a new, more enlightened and human approach could not have been evolved with considerable success in the treatment of those who expected, and were prepared to accept, British leadership.

Perhaps even more striking is the lack of success in co-ordinating domestic and foreign economic policy, which so much contributed to the crisis of 1947.<sup>1</sup> Indeed, the Government, as we have seen, even failed to make full use of the opportunities presented by the fact that the U.S. was, at one moment, not merely prepared to accept European planning, but was pressing for it, and that only the British could conceivably give a start. Their failure in maintaining the initiative they had gained at the Paris Conference, after the inauguration of the Marshall Plan, was discussed in an earlier chapter. We have seen that the British approach to the solution of their national problems substantially contributed to the failure to establish an effective common programme. This would have offered immense diplomatic advantages to all. So long as the British Government does not succeed in giving an effective alternative which induces other countries to co-operate with Britain, it can hardly complain of their policy.

Equally little effort was made to overcome the distrust of their

<sup>1</sup> Cf. Appendix below, 'Britain's Economic Problem,' on the influence of foreign commitments in the convertibility crisis of 1947.

programme by wide circles in the U.S., and to counteract the massive impression created abroad by the steady stream from Britain of books, periodicals, newspapers, or even broadcasts, unfairly hostile to the policy of the Government, which must have increased prejudices in any case prevalent in America. A spate of charges were stimulated by the devastating, if superficial and misleading, impressions created by the fuel crisis. The great achievements of the Government were suppressed. In the absence of statistical information, for which the Government bears some responsibility, it was rather freely and airily suggested that production and consumption were slumping, that inflation was rampant, that wage demands were running away with the stabilization policy, and that food subsidies were adding to the inflation. The fact that most of the failures were due to the concessions of the Government to the policy of their critics was equally firmly drowned in silence.<sup>1</sup> This palpably partisan and largely untrue presentation of developments was not duly dealt with on a scientific—as contrasted with political—plane. The Government's surveys were largely handicapped by the Government's strange distrust or lack of realization of the full implications of democratic planning.<sup>2</sup>

In the longer run such charges discredit the accusers, however unfavourable their immediate effects abroad. Unfortunately, the Government has tolerated an administrative system which resulted in the Cabinet and the country being taken completely unprepared by two serious exchange crises in two years. There can be no excuse for this.

The blow to planning and to the attempt to maintain full employment and achieve social progress must not be minimized. The lesson must be thoroughly digested and apposite reforms instituted. The reason for this ill-success can primarily be found in the lack of assurance and definition of the Government's conception of the nature and means of democratic planning, and the consequent

<sup>1</sup> Cf *ibid*

<sup>2</sup> Even at home the Government did little to secure a balanced discussion of their economic policy even where, as in the case of broadcasting, they had the power and duty to insist on fair treatment apart from the fixed share-out of 'party political' speeches. Political propaganda might win elections. But it cannot produce informed public opinion on which the ultimate success of a new social system ultimately depends. The obvious bias of most economic commentators inevitably raises the question of how the problem of securing a balance in the presentation of opposing points of view is to be secured in training future administrators and technicians.

inability to perceive that constitutional conventions, including conventions on the relations of the Government to Trade Unions, evolved in the heyday of the negative, *laissez-faire* State, must thwart positive State initiative. If a more constructive domestic and international approach to economic problems is to be adopted, the Government will have to re-examine:

- (a) The nature and means of democratic planning.
- (b) The statistical basis and procedure needed to ensure rapidity and flexibility in action.
- (c) The administrative organization needed to give effect to policy as the existing machine is obviously incapable of carrying the weight of the new tasks.

Let us examine these points in detail.

#### (a) DEMOCRATIC PLANNING AND FULL EMPLOYMENT

The policies of reinforced yet balanced fiscal and direct controls adopted after the breakdown of 'convertibility' in 1947 have been vindicated in 1948 more completely than anybody dared to hope. We have, in an earlier chapter, discussed the salient features of the British recovery of 1948. We must now throw a glance at the relative position of Britain in Europe to counter the renewed campaign of denigration. Industrial production in 1948 was 21 per cent higher than in 1938, the highest level achieved by any of the Western belligerents.<sup>1</sup> A comparable recovery was not achieved throughout the inter-war period. Industrial productivity increased at the rate of almost 5 per cent p.a., as against 3 per cent p.a. in the best phase of the inter-war period, and was 8 per cent above pre-war in 1948.<sup>2</sup> Comparable figures, for example, for Belgium are nil and minus 3 per cent. In this respect, also, Britain was first among the Western belligerents. Net investment (taking into account the balance of payments) at 11 per cent of the national income was almost double the 1939 rate and the highest in Europe.<sup>3</sup> The volume of exports was 36 per cent above pre-war, while, for example, Belgium was 4 per cent below that level, and no other country except Switzerland had even reached its pre-war export volume. So much for the charge that the British performance was behind all other European countries.<sup>4</sup>

<sup>1</sup> E.C.E., 1949 Report, p. 4.

<sup>2</sup> *ibid.*, p. 6.

<sup>3</sup> *ibid.*, p. 46.

<sup>4</sup> e.g. Mr. Churchill, the *Observer*, July 24, 1949



But it seems that the Government itself was not completely convinced by its own success. The approach adopted in the British Memorandum to O.E.E.C. on the Four-Year Programme is very similar to that of the Economic Survey for 1947.<sup>1</sup> Planning, it was said, cannot be considered as an end in itself, but only as a means to an end. This might mean that the Government considers planning, i.e. co-ordination of policies for a given end, as an essential feature of our economic system because free-market economics cannot be trusted to achieve a balanced and justly distributed increase in the national income, in the present position in Britain. Alternatively, it might be interpreted as meaning that the Government regards government intervention merely as a transitory measure necessitated by the exceptional circumstances caused by the war, and that, as prior to 1947, and again in 1948-9, it will be discontinued whenever it seems that 'scarcities' have disappeared.

Those who reject *laissez-faire* and the so-called 'planning by the price-mechanism', base their rejection on the bitter experiences of Britain in the inter-war period, which is reinforced by all that has happened since the end of the war. This experience shows that, at any rate in Western Europe and Britain, an uncontrolled market economy cannot in the essential matter of capital investment and saving give effect to the wishes of individuals, far less of the community, and that its functioning involves injustice, inefficiency, wastage and unemployment.

As the Government's policy has unfolded in the last years, it was becoming clear that they adhered to the second, more restricted interpretation of policy, and assumed that the need for preserving consumers' sovereignty precludes planning in detail, or the reinforcement of control to ensure the fulfilment of plans. This view seems based on the fallacy of applying to the present situation the tenets of a highly abstract theoretical model which never existed, and cannot exist. It disregards first of all the overwhelming importance of Government decisions in determining the magnitude of demand through its budgetary and monetary policy. It should be remembered in this connection that the existence of controls has a direct bearing on financial policy. Shortages, if distribution is not controlled, cause a rise in prices, and the rise in prices might spread throughout the economy.

<sup>1</sup> Cf Worswick and Burchardt, *Bulletin of the Oxford Institute of Statistics*, 1947.

Thus the concept of shortage is itself ambiguous. Apart from certain goods, the demand for which does not increase, or even falls, as income increases, shortages will depend not merely on the state of supply, but also on the level of demand, i.e. national income and spendable liquid reserves. The theoretical argument showing that rationing decreases enjoyment as compared with that obtained from the same money income at identical prices without rationing is incontrovertible. It neglects, however, the fact that in the absence of controls it might not be possible to maintain the same level of money income without leading to a rise in prices and/or to worsening of the balance of payments. If the demand for certain commodities must be reduced, and the demand for those goods is very intense, the general lowering of incomes required in order to achieve the desired cut in consumption might have to be very sharp. In order to dispense with rationing and other physical controls, money resources will have to be made the narrowest bottleneck in the economy. In the short run, when resources cannot be shifted without undue social cost, the abandonment of controls might have to be paid for by sharp unemployment, or at least the under-employment of resources which at the margin do not absorb factors of production in proportion to the outlay, e.g. entertainment, travel, etc.

To give a physical illustration: if someone were to desire to dry up part of a lake, he could put up a cofferdam and pump out the water behind it. The water in the lake would rise, but if the sides of the lake were well buttressed, nothing catastrophic would happen and the operation could be accomplished with the least physical disturbance to neighbouring areas. If the same undertaking were to be attempted by a lowering of the level of the water in the lake, enough would have to be pumped away to leave the area enclosed by the cofferdam dry. It would be an accident if other land would not lie above the level of the strip to be drained. If so, it would get parched in the operation, whether we want it or not. The lesson is plain.

If viewed from this angle the reputed lack of subtlety of direct controls does not appear to be so great as compared with general financial controls. In a country such as Britain, in the economic structure of which foreign trade plays a large rôle, this consideration is of special importance. *Controls over production and consumption represent the most effective and flexible means of imposing selective*

pressure, equivalent to localized deflation, on industry without incurring the need for a general cut in incomes, causing unnecessary hardship and unemployment. It will be possible to isolate internal purchasing power from interfering with the export drive in individual essential export industries.<sup>1</sup> We shall be able to cut the consumption of certain goods which most depend on relatively expensive imports. We could concentrate measures in those lines in which success is most likely, without having to curtail expenditure and employment unnecessarily in others. By direct controls demand can be cut to fit in with productive or import/export bottlenecks, and the resulting excess demand directed to innocuous uses, i.e. uses which do not absorb additional factors of production, e.g. entertainment and travel.

The second and even more serious objection to decontrol in European countries is that the war has unbalanced the productive structure and the readjustment can proceed only slowly. If we attempt to cut demand by general measures to fit in with the narrowest bottleneck, this will result in unemployment elsewhere, and, what is even more important, it will necessitate a decrease in investment, i.e. a decrease in the rate of progress and in particular in the rate at which a balance of the productive structure can be achieved. Controls can adapt demand to the existing productive structure, using the latter to the full. General monetary measures cannot accomplish this task, hence cannot guarantee a high level of investment and full employment. The fact is sometimes quoted against the use of controls that they maintain artificially a structure of production which has become inappropriate. This is perfectly true, but does not constitute an argument against controls. Adaptation is bound to be slow, as has been shown in the inter-war period. While maintaining full employment, special steps must be taken to promote readjustment. But nothing is gained by imposing a general deflation. This will retard the emergence of a new equilibrium as it discourages investment generally. Controls are therefore far less inimical to an adaptation of the economic structure to a new situation than the free working of the price mechanism. If disinfla-

<sup>1</sup> The success of the export drive was an ironical comment on the simultaneous publication of countless books and articles complaining of the stifling of the export drive by 'inflation'. It would also be interesting to know how some writers imagine the maintenance of anything like the present national income without controls while imports are throttled to some 80-85 per cent of pre-war.

tion does not cause large-scale unemployment, the pressure on individual firms seems hardly adequate to force them to engage in an all-out price struggle which would further worsen their position. It is more likely to strengthen the trend towards tacit or explicit restrictive practices. If, however, the Government were prepared to pursue a policy of ruthless deflation—and face the immense social loss involved—it is unlikely that no efforts would be made to lower wage-rates; expert economic opinion could be easily secured showing that British wages had risen faster than the average increase of the productivity of labour. Instead of reorganization, standardization, and new investment in order to increase productivity, a cut in wages is surely more likely in a period of deflation and unemployment. Thus the aim of all progressive economic policy would be vitiated. The former reluctance of the trade unions to countenance measures increasing productivity would certainly revive with redoubled force.

It should not be forgotten, moreover, that changes in foreign demand more often than not represent short-term fluctuations in the absolute level of effective demand abroad, and not structural changes. The free working of the price mechanism would enforce losses on the community without any apparent gain in the long run. As Britain imports necessities and exports mainly luxuries and capital goods, the demand for which is notoriously unstable, the deflation necessary to achieve a given result in limiting imports and forcing exports might have to be very sharp. Decontrol, therefore, limits the capacity to maintain employment and social justice in the face of foreign complications.

Cyclical fluctuations are in the main associated with the tendency of capitalist economics, if uncontrolled, to develop cumulatively increasing speculative investment once an expansion has started. Thus once expansion has started, it is self-inflammatory. As investment increases, prices and profits increase, which induces further investment. Violent fluctuations in stocks—working capital—further distort and exaggerate the movement. In the end the misjudgement of durable profit opportunities induced by the inflation results in a disappointment of original expectations, further investment is not undertaken, and the whole system is involved in a cumulative deflation. Stability is therefore dependent on effective controls over investment. It can be shown, however, that financial controls, even

direct financial controls, cannot be made effective. A large part of the investment does not depend on the capital market, nor is it financed through the banks. Indirect means such as variations of the rate of interest are, however, ineffective, because, once an inflationary spiral starts, the profit opportunities are far too high to be influenced by slight changes in the rate of interest. In order to be effective the rate of interest would have to be wielded like a battle-axe, indiscriminately putting a stop even to such investment as is needed for steady progress. It does not seem to be either a discarded sieve or an old corset, as some people affectionately call it.

The checking of periodic inflationary bouts would require increasing rates of interest. The long-run trend towards increasing capital intensity, however, requires a steady decrease in their level. It has been shown conclusively by past experience that it is not possible to combine an anti-cyclical interest policy with a policy calculated to stimulate the steady expansion of capital investment. Thus stability requires the maintenance of direct controls over the main field of investment so as to prevent inflationary spirals and maintain an even trend of investment. As capital accumulates, the enforcement of a fall in the rate of interest appropriate to the increased volume of capital becomes more and more difficult. The problem arises, therefore, how to maintain demand. This can be done partly, especially in rich countries, by stimulating capital export so as to mitigate the international differences in capital intensity and the standard of life. Steps can be taken, secondly, to redistribute income by progressive taxation so as to decrease the inequality in the standard of life and thereby at the same time maintain demand (as the rich save more than the poor and thus the redistribution decreases saving). This, indeed, is the main method by which those who believe in the effectiveness of the price mechanism without controls hope to achieve full employment and social justice. Unfortunately, the establishment of greater social equality interferes with the working of an economic system based on risk-bearing and profit expectations.<sup>1</sup> Plans based on progressive taxation to reduce inequality of income do not usually take into due account the effect of taxation on the willingness to invest. Without measures calculated to reduce the risk of fluctuations and

<sup>1</sup> Cf e.g. the review by R. F. Kahn of Professor Meade's 'Planning and the Price Mechanism,' *Economic Journal*, March 1949, p. 3.

losses, redistributive schemes are hardly likely to achieve their object. What is needed to secure stability and greater social justice is not the mitigation or counter-balancing of business cycles, but their elimination. There is no reason to doubt that if the steady increase in the basic minimum standard of life were to be the first charge on economic progress, that is to say, if mass consuming power were to be always kept high enough to cause a slight inflationary tension, and if this inflationary tension were kept in check by direct controls, this object could be fulfilled. Once there is little risk of a certain collapse of markets, even relatively small net profits after taxation will be sufficient to induce investment. One of the most important of the measures to increase the basic standard of life is the provision of increasingly better standards of housing at cheap rates. In so far as this involves large investment, it also represents the most powerful sustaining factor in an economic system. Any fluctuation from abroad or other unforeseeable changes in output, e.g. crop failures, can, in this controlled system, be put on the shoulders of those who can most easily bear it, i.e. it will fall mainly on luxuries. Foreign fluctuations, instead of causing unemployment, will be offset by a worsening of the terms of trade (in so far as they are not isolated from the system by reciprocal bulk purchase agreements).

Certain choices, which, moreover, form an increasingly important part of total activity, can only be taken collectively. They are, on the one hand, acts of collective consumption, e.g. redevelopment of towns to ensure suitable environment, education. Free market economics tends consistently to undervalue the relative importance of these needs. On the other hand, it encourages—especially as competition is limited and product differentiation prevails—large diseconomies of consumption. Conspicuous waste, changing styles are stimulated by the attempt of firms to secure for themselves exclusive markets. Experience in America suggests that it is impossible to deal with this phenomenon by negative legal sanctions. No act of overt collusion is necessary to encourage or maintain this trend towards social waste. The consumer is thereby deprived of his freedom of choice as an alternative is not offered. State competition and control over quality, at least, the provision of standard products whose price is controlled so as to provide an effective alternative, seem the only means of bringing about that state of

affairs which orthodox economic theory describes as in being. The case for the permanent retention of controls is very much increased in those countries which, like Britain, have been subject to a steady decline of competition and which, moreover, suffered from a large-scale distortion of their economic system, in the case of which, therefore, the extent of the required readjustment is very large.

Finally we come to the problem of determining the rate of progress. Classical theory postulated that an optimum distribution of resources will take place not merely as between alternative uses, but also between current consumption and accumulation, by the interplay of supply and demand on the capital markets. This view disregards not only that the rate of savings will depend mainly on the level and distribution of national income, but also that individuals, when making their decisions, cannot be in possession of all relevant facts, and even if they were, cannot be certain that their savings decision will become effective and not be frustrated by the failure of investment to balance savings decisions. The claim of the adherents of free market economics that that mechanism automatically establishes a unique position of equilibrium and secures an optimum rate of progress fails.

The decision as to the rate of progress must be taken collectively with due consideration to the relevant factors affecting the community as a whole. In the case of a country such as Britain, being largely dependent on foreign trade, much the most important of these considerations is the relative rate of progress in the dominant country of the world economy to which Britain is linked, the U.S.

It seems essential, therefore, not only to reserve the decision on the rate of saving to the community as a whole, acting through constitutional channels, after due discussion of the relevant issues, but also to render this decision independent of the distribution of the national income. It would be intolerable if the need for quicker progress should result in promoting a greater inequality of income distribution so as to bribe the rich into saving—having first increased their conspicuous spending—as actually happened in Germany by deliberate policy. Both aims require the maintenance of direct controls. If the second is to be attained, savings will have to be either collective, i.e. through a budget surplus, or collectively enforced, i.e. by maintenance of rationing. A budget surplus alone,

however, would not guarantee that a degree of dissaving would not ensue, sufficient to reduce net savings below the rate desired. Moreover, the increase of the rate of taxation beyond a certain point is likely to have unfavourable effects on incentive, though the inter-relationship is more complicated than is usually assumed. It can be, and has been argued, that rationing by diverting excess purchasing power towards innocuous uses has the same disincentive effect as taxation. While, in the one case, net income after taxation is reduced, in the other the range of choice of the commodities or services for which the income can be used is restricted, i.e. income is made less attractive. It has been shown during the war, however, that the public regarded taxation measures, including forced saving, as a greater deterrent than the lack of opportunities to spend. The argument which assumes that a restriction of choice immediately decreases effort also seems to imply that only the middle classes have any desire for accumulating reserves for retirement or against unexpected contingencies. This may be so, but no proof as yet has been furnished that it is in fact the case. Until such proof is given it would be reasonable to act on the hypothesis that rationing as an alternative to taxation is less inimical to incentive and progress.

We may conclude, therefore, that in our present position controls must be regarded as an alternative to a sharply deflationary policy. In the relatively favourable international situation of 1948 the policy of decontrol merely resulted in a premature dissipation of the increasing productive capacity for an increase in luxury consumption and the relative worsening of the distribution of effective consumption. The rich began to bring their capital to bear in buying consumers' goods. The gravest danger of this policy was the threat of this development to the maintenance of wage stabilization. The Government did not have to envisage the logical conclusion of its policy of decontrol, the forcible reduction of mass-consumption, so long as the international position remained favourable. They were brought face to face with the basic dilemma as soon as foreign demand fell away.

Full employment by deliberate action ensures a social balance and is therefore the sole basis for democracy. It is noteworthy in this respect that the need for deliberate safeguards in the defence of social harmony have been, almost without contradiction, accepted for some hundreds of years in the political field. It has been equally



consistently denied in economics. Yet it is perfectly clear that this denial has been based on the assumption, long ago confounded, that the mass of the population, the working class, is subject to certain immutable economic laws. Any interference with these economic laws was regarded as self-defeating. Unless this assumption is defensible, the moral basis of the policy disappears. In point of fact, the operation of these laws depended on the existing legal system concerning property rights on the one hand, and the lack of economic power on the part of those not possessing capital on the other. Once the social inequality and political impotence of the worker as an individual is removed by his right of association and political representation, this one-sided relationship depends entirely on the economic power of the entrepreneurial class to inflict unemployment and thus weaken the power of resistance of trade unions, once its 'confidence' has been shaken, e.g. by any measure which impinges on the ultimate economic power of the entrepreneurs. The resistance of the entrepreneurial classes to State measures calculated to maintain full employment is based on their correct intuition that such measures, while they safeguard their short-run profits, would, in fact, undermine their ultimate source of power, the power to decide the level of business activity and thus their relative bargaining power as a class.<sup>1</sup> In this they have a better appreciation of the true inter-relationship in the present economic system than those economists, including the late Lord Keynes, who regarded the resistance of the bankers against anti-deflationary measures as a consequence of suicidal stupidity. Once the power of inflicting slumps is removed, the entrepreneurial classes lose their rôle as absolute rulers; a balance is established which will force deliberate measures and decisions on matters of economic policy which was hitherto their sole prerogative. In particular, deliberate decisions will be needed on the distribution of the national income and consequently also on the rate of investment and progress. The fact that in a complex economic system correct decisions cannot be made on the rate of accomplished (ex post) investment by individuals acting as individual savers and investors respectively (as the failure of the mechanism does not provide a guarantee of maintaining full employment) has been the most potent cause of the fall of orthodox economic theory and with it of liberal economic policy.

<sup>1</sup> Cf. the previous chapter.

The maintenance of full employment is equivalent to a slight inflationary monetary tension, and cannot be dissociated from it. In an uncontrolled economic system it would, *ipso facto*, give rise to a cumulative inflationary spiral. Thus the maintenance of full employment, or any state of employment which would evoke a feeling of full employment on the part of trade unions, cannot in the long run be maintained without some system of direct controls. The extent and the character of the minimum controls necessary is a matter on which no pronouncements are possible *a priori*. It will depend entirely on the nature of the economic system to be controlled and its historical situation. In a country such as, for example, the United States, which is largely independent of foreign fluctuations and which, through the historical accident of being the arsenal of the major part of the world in two world wars without suffering any economic loss in her own territory, has become by far the richest country of the world, with an enormous potential capacity for investment and accordingly of rate of progress, controls can be restricted to a minimum. It is possible in that country to maintain full employment by fiscal measures alone, and bring about a juster distribution of incomes and consumption by taxation, so as to secure the compliance of organized labour in a policy of stabilization. In the countries of Europe unbalanced by the war, and having no reserves, direct controls of varying degree would be necessary to prevent full employment from resulting in a cumulative inflationary collapse. Controls are the alternative of unemployment induced to hold the workers in check.<sup>1</sup> Those who oppose controls, indeed, openly yearn with varying intensity for a varying measure of unemployment.<sup>2</sup>

Increased efficiency through industrial reorganization, as well as the maintenance of full employment in an unstable world, would therefore seem to depend on the reinforcement of controls. This does not mean that existing controls should not be overhauled and, if possible, simplified. They were established during the war

<sup>1</sup> This has been shown by the German experiment.

<sup>2</sup> In most cases they merely state that the 3 per cent unemployment contemplated by the Beveridge Committee was too low. 5 to 8 per cent is the usual guess of the minimum needed to ensure stability or 1-1.8 million in Britain. In point of fact the experience of the inter-war period suggests that much higher figures would be needed. At 10-12 per cent unemployment, definite wage pressure made itself felt in the 1930s. And Trade Union organization has improved since. Few of these authors, the inverted followers of Marxist teaching, have given detailed reasons for the modesty of their estimates.

exclusively for the purpose of concentrating productive resources for the war effort, and are ill fitted to cope with new tasks. The excessive preoccupation of the authorities with 'fairness,' due to their overwhelming desire to escape responsibility for discriminating decisions, inevitably imparted unnecessary rigidity to direct controls. The method of basing allocations or production on base periods is one of the outstanding examples of this failure. The removal of raw material allocations, at least of the more important ones, will come last, as they involve imports. The entrepreneur therefore need not be afraid of an increase in competition. Precious time has been lost without evolving methods which enable a selective stimulus to be given to efficiency and exports. The example of steel allocations to the automobile industry, which ensured a volume of exports held to be impossible by the producers and speeded up standardization, shows what could have been done if more imagination had been applied elsewhere. Part, at least, of the responsibility lies in the unsatisfactory method of selecting the personnel of controls, inherited from earlier governments.

True enough, price controls have in most cases been maintained. With the relaxation of the utility schemes, however, and the failure to undertake a reform of other controls, their effectiveness has been sharply diminished. It would hardly be possible any longer to enforce productive reorganization by price control alone without a considerable reinforcement of the controls over production. The history of the first two years of the war has conclusively shown that partial control of this character (i.e. having no direct influence either on consumers' demand or on the successive stages of production) can easily be evaded. Unfortunately, little if any attention seems to have been paid to these wartime experiences. In the process of derationing, all those mistakes, which retarded the war effort during the initial period of the war, have been repeated. Instead of gradually relaxing controls by administrative changes, rationing was altogether abolished in parts of a connected field, thus putting additional strain on the sector which remained rationed and causing considerable disorder in the higher stages of production.<sup>1</sup> All avail-

<sup>1</sup> This happened not only with respect to textiles but also to points rationed foods. In the case of sugar certain end-products were freed, e.g. sweets and preserves, while the rationing of sugar remained. The distortion of the consumption pattern and the resulting irritation was considerable. In many cases considerable shop-shortages arose, and the same sort of favouritism and haphazardness in distribution could be observed as those which gave rise to criticism during the war.

able evidence suggests that labour costs in Britain have not increased out of proportion to costs elsewhere.<sup>1</sup> We must suspect an increase in monopolistic profit margins because available controls were not wielded with sufficient energy. It seems that especially the laxity of export controls, and the permission to sell in the home market export goods, has had serious effects on the efforts of entrepreneurs to sell abroad. Such laxity in detail might make a general deflation inevitable.

Unfortunately, opinion has been bedevilled by the dispute whether controls should be regarded as an alternative of the price mechanism or not. As Sir Hubert Henderson has shown in his witty presidential address to the Economic Section of the British Association,<sup>2</sup> no control could, or should, attempt such an insensate task. What is required of them is the prevention of short-term speculative exaggeration of price movements and of fluctuations in investment and employment which such price movements cause, only to be accentuated by them. By checking a sudden increase in stocks, a cumulation of investment projects due to bottlenecks, they ensure stability. On the other hand, the stabilization of the cost of living through subsidies to the price of essentials permits the restriction of wage demands and with it a cumulative inflationary spiral which could only be checked by sharp deflation and unemployment. Finally, a properly working price and quality control applies steady pressure on monopolistic profit margins, and together with a flexible method of allocation of certain key raw materials, promotes efficiency. Controls in Britain—and in Europe—are needed not in order to replace the price-mechanism, but to make it work as it is said to work by an abstract theory, which does not stop to consider whether the price-system in present conditions can fulfil its functions. No perfection can or should be claimed for its performance. As any other human institution, controls will certainly be mismanaged at times and will never work smoothly. What might be claimed is that they are capable of improvement so long as they are not regarded as stopgap measures to be discarded at the first occasion and not worth much thought and effort. By eliminating a one-sided pressure on the working class, they hold out some hope for the diminution of social tension and the establishment

<sup>1</sup> Cf. the E.C.E. statement on labour costs, op cit

<sup>2</sup> 'The Price-System' Reprinted in the *Economic Journal*, December 1948.

of a balanced society. Experience in Europe both before and after the war shows that given some understanding on all sides, deliberate action might be capable of preventing the appalling waste of large scale unemployment, and of mitigating the unequal distribution of income without revolutionary upheaval.

Public opinion and even the Government did not seem to have had sufficient opportunity or information to explore these problems and the implication of the choices facing the country. The short-run attractions of discontinuing controls were great and therefore insidious. Both the consumer and the producer seemed to benefit. Decontrol was, therefore, taken as a triumphant sign of progress well accomplished. The unfavourable effects of the discontinuation of controls were slower to materialize and difficult to connect with the original policy.

As demand is liberated, prices necessarily tend to rise because the well-to-do are free to use accumulated wealth for current purchases. Hence the distribution of current consumption becomes less equal and the policy of stabilization is endangered. Any foreign shocks can no longer be met by special measures exerting selective pressure on entrepreneurs and consumers in those sectors which can most contribute to the balancing of the position, but enforce general measures of deflation.<sup>1</sup>

The Government's statements<sup>2</sup> on its basic conception of the inter-relation between democratic institutions and direct controls seem, therefore, to move on a plane of abstract generalizations which do not take account of the realities of the position. This conclusion is strengthened if we consider the methods of elaborating, presenting and securing parliamentary acceptance for the economic programme of the Government which must prevent an active participation through public discussion of the community in the decisions. Democratic planning cannot mean the elaboration of a series of disjointed targets, on the basis of more or less random

<sup>1</sup> This is clearly exemplified by the German experiment in decontrol. The abolition of controls resulted in a surge of purchasing power towards certain bottlenecks. This in turn necessitated general deflation. In consequence, stability was achieved at the cost of heavy unemployment and the throttling of investment in housing, despite the crying need to re-house refugees and incorporate them in the productive process. The slowing down of German recovery has been considerable and might affect even industries, e.g. steel and coal, the demand for the product of which should be secure for long years to come.

<sup>2</sup> These were reaffirmed as recently as the policy statement prepared for the Labour Party Conference in June 1949, and published under the title *Labour believes in Britain*. Cf. my paper 'Stability and Controls,' *Socialist Commentary*, April 1949.

guesses of a few officials of what the consumer (and autonomous departments each jealously defending its own 'interests') is likely to 'stand,' with an anxious eye on possible retrospective criticism. Democratic planning cannot mean that these targets, having been hurriedly assembled in the last minute, generally leaving insufficient time for digestion even to the Cabinet, should then be presented as unalterable plans to the Commons under the threat of a vote of confidence. What democratic planning should mean, if it is to mean anything, is a conscious choice between clearly-stated alternatives, based on a thorough exploration of the implications of the choice on the present and future position of the individual. A much closer interaction between public opinion and Government planning is needed, and this can be achieved only by consistent publicity and serious discussion.

This would enable the Government and Parliament to make their choice consciously, weighing the alternatives as they affect the individual. It would force all concerned to face critical issues, instead of, as at present, indulging in incoherent wish-dreams and shirking vital decisions. In particular it would face the various vested interests, including the rank and file of the Trade Union movement, with a clearer realization of the implications of the choice before them, instead of leaving it to recurrent crises to force the unwilling acceptance of belated measures, the harshness of which is bound to increase with the delay.

It is at least doubtful whether public opinion would have favoured the policy which the Government pursued if the issues had been presented clearly. The restrained attitude of most of the leaders of the Trade Union movement shows how much can be accomplished in this respect by courageous clarity. It is noteworthy, moreover, that even during the war it was public opinion which prodded the Administration into more complete mobilization of economic resources for war, while the Government hesitated to apply strong measures for fear of appearing 'totalitarian.'<sup>1</sup>

So long as the Government regards democratic planning, not as a means to secure enthusiastic collaboration, but as a system of negative restraints which must be kept to a minimum, Britain is unlikely to avoid recurrent crises.

<sup>1</sup> Cf. e.g. Mr. Bevin's statement on the Emergency Powers Act in June 1940. In 1941-2 he was forced to take the measures advocated by his critics.

(b) THE STATISTICAL BASIS

The Government itself emphasizes the fact that it does not regard its plans as definitive. They depend on certain assumptions. It is invariably hoped to better the performance. Given the uncertainty of the foreign situation, this to some extent is inevitable. But surely it would be better to give some estimates of possible alternatives or at least the range of quantitative relations based on alternative hypotheses. The economic plan, unlike the budget, does not give opportunity for speculative gains.<sup>1</sup>

Moreover, the continued failure to secure up-to-date information on a vast range of strategically vital points of the economic system must be regarded as an odd reflection on a Government pledged to full employment and a planned maximization of the national effort. The weakening of controls should have been an incentive for strengthening the intelligence at the disposal of the Government, as the action of the indirect—monetary—devices is much slower and weaker and therefore demands prompter action. A comparison with the Economic Report of the President of the United States to Congress invites comment. The statistical tables accompanying that report occupy more space than the whole of the British Survey. Not only are the figures for the national income and output as well as its constituent parts available quarterly in the United States, with a lag of less than a month for a preliminary estimate which seems accurate enough for general policy decisions (e.g. the report on 1948 was submitted on January 7, 1949), but detailed information was given on productivity, stocks, retail and wholesale trade, of which little is known in Britain. Field studies were available on the liquid resources of the community and the anticipated ways of spending. The investment programme of the great corporations was tabulated and digested. A prodigious feat of statistical analysis has been performed without much fuss.

In this country we are still in the dark about the more important results of the 1946 partial industrial census. The full industrial

<sup>1</sup> The loosening of the control machinery, in any case, imparts some unreality to any plans, just as the programmes submitted to O.E.E.C. by most Continental countries cannot be regarded as more than informed (and optimistically biased) guesses. Unfortunately the political consequences of missing targets are distinctly disagreeable. Hence the officials framing the Survey would, in this country, have a tendency to understatement to safeguard ministers. As alternative plans are not prepared, with varying assumptions on foreign conditions, the 'Survey' figures nevertheless have given cause to much criticism.

census might not, perhaps, be available for a few years. Characteristically, we are unable to form views on the relation of costs of firms in any one industry and of gross to net profits, matters which would be fundamental for price control and anti-monopoly measures.<sup>1</sup> The census of distribution has been postponed until 1951, though the Government seems to regard the rationalization of the unknown structure of the retail trade as one of the most important aims in the next five years. There are no comprehensive figures available for the volume of commodity stocks at each stage of the distributive process, though it is agreed on all sides that the filling of the bins is one of the most important measures to increase productivity. Moreover, the short-term variations of the circulating capital might represent potentially the most disturbing factor in maintaining stability and preventing speculative attacks on the currency. Only the scantiest information is available on productivity; a large part of it is carefully kept from the Government. The work of the Anglo-American Productivity Council seems to proceed in secrecy. Even the analysis of the economic implications of Government receipts and payments is rudimentary in comparison with the United States. The seeming confusions of, and the delay in, the presentation of the balance of payments statements is also disturbing.

Under these conditions the experts responsible for elaborating the White Papers on the British economic plans must be congratulated on their ingenuity and patience. But the system of government which methodically starves the intelligence and statistical services, and conducts negotiations with the representatives of the various important organized groups in the community as if they were sovereign great powers, can hardly be excused. In consequence,

<sup>1</sup> Cf. T. Barna, 'Those "frightfully high" profits,' *Bulletin*, Oxford University Institute of Statistics, 1949, for a review of the curious problem encountered on a vital point which, above all, should interest a Labour Government. Even the Treasury receives the statistics on true profits only since Lord Keynes insisted on and carried the point during the war. The discrepancy between home and export prices in favour of the latter continues and in present conditions suggests that insufficient pressure is exercised on entrepreneurs. Otherwise export prices would have declined with the cessation of sellers' markets abroad. While a general decline in British prices in terms of foreign currencies brought about by devaluation would cause unnecessary losses, such selective declines must be brought about to maintain the volume of trade. No one suggests, however, that home prices are not remunerative. The failure to obtain and publish facts on this matter has considerably contributed to the unjustifiable campaign against sterling which endangers the whole structure of the Government's policy.



both the framing and the criticism of Government plans is subject to a grave margin of error.

It is an astonishing fact that such defence of the Government's policy as could be offered had to be based mainly on the Reports elaborated by the Economic Commission for Europe, which was consistently starved of information by the British authorities. The linking up of the pre- and post-war production index was first accomplished by that organization; calculations in respect of productivity, relative wage-levels, comparisons of net and gross investment, rest mainly on those reports. Nor was an objective defence of the bulk-purchase arrangements possible until their work was published, owing to a complete lack of statistical information.<sup>1</sup>

A greater realization of the importance of the work, and fuller use of its powers, ought to have enabled the Government to produce much more detailed and accurate statements of the position and prospects, and thus stimulated a much greater concentration of effort. Once the pressure of unemployment and hardship is removed, only an intelligent appreciation of the dangers and possibilities can induce full co-operation. The basic administrative needs of the programme to which the present Government is pledged have been strangely neglected.

### (c) THE RENEWAL OF THE DOLLAR DRAIN

As we have seen in an earlier chapter, the British plans for the next years were based on a cautious optimism regarding the immediate outlook for world economic activity and the level of foreign trade. In this they followed the instructions of the American Administration. The programmes elaborated, however, did not fully utilize the favourable general background implied in these assumptions, nor point with sufficient firmness to the fact that

<sup>1</sup> Characteristically, the British Government expressed dissatisfaction with the work of the Commission, the only international agency whose statistical investigations directly supported British policy, and demanded a sharp cut in its Budget (Report in *Sunday Times*, July 10, 1949). American and European reports on this strange incident emphasize the fact that Britain was not supported even by the other Western Powers in this unjustified and undignified attack. The unfavourable comments in the foreign Press were not reported by most British newspapers. This shows an aspect of the problem of the Press which received insufficient, if any, attention by the recent Royal Commission, the growing influence in the treatment of news, of suggestions by official spokesmen sustained not by censorship but other, equally powerful means. Many hardly less glaring examples could be found in the presentation of other important issues of foreign policy.

their implementation would depend on these assumptions being fulfilled. Thus they incurred acute hostility not only in Europe but also in the United States. The sharp cut in the British request for Marshall Aid for the second year by as much as 25 per cent did not win plaudits. The remainder of the participating countries either did not reduce their requests (some actually increased it) or reduced them by much smaller proportion. This misplaced virtue—apparently contrary to U.S. advice—was not rewarded. It would, perhaps, have been more prudent to maintain the request for Marshall Aid and intensify investment programmes and also to plan for a greater contribution to the expansion of multilateral trade with Europe. A reserve could thus have been formed to act as a shock-absorber if any of the assumptions of the American Administration were to be proven too optimistic, without having to cut consumption immediately.

The rigidity of British planning methods was also shown by the fact that little notice seems to have been taken of the acceleration of decontrol measures in evolving financial policy. So long as direct controls over imports, production, and consumption are maintained, it is, as we have argued, possible to divert consumption demand towards innocuous channels. This escape from any pressure emanating from abroad was steadily closed in 1948–9. The pressure on selected industries to sell abroad rather than at home, even at less remunerative prices, was reduced by the relaxation of control. And consumers were less restrained from consuming commodities which absorb a large proportion of scarce commodities and manpower. Calculations mistakenly made at the time of the first balance of payments crisis of 1947, connecting the deficit directly with the state of Government finance and investment, have become more apposite. The 1949 budget did not draw the logical conclusions of this policy—it would have had to be drastically deflationary to pave the way for the further ‘bonfires of controls’ or even justify those already lit.

Nevertheless, it would seem that the conclusion that profligate Government expenditure on social services, especially on food subsidies and the health service, the ‘Welfare State’ and far too ambitious investment programmes, are responsible for the recurrent discomfiture of the country is a dangerous oversimplification. As we

have seen,<sup>1</sup> the British balance of payments showed a steady improvement since the first half of 1947. In the second half of 1948, not only no net contribution from the U.S. was received, but a net export of capital of £30 million was recorded.<sup>2</sup> In the first half of 1949 total exports further increased some 10 per cent, and the visible adverse balance of trade was reduced to £45 million, or the smallest yet recorded. It is more than probable that an overall balance has been maintained. In particular, the volume of exports to the United States and Canada almost doubled as compared with pre-war, while imports were considerably reduced. This was not the case in any other European countries. Obviously the United States' slump would affect British exports much more than those of other states which have not made similar efforts.

These figures for the whole of the first half of 1949, however, hide a serious deterioration in the second quarter which came after the most favourable post-war performance in the first three months of the year, and they obscure a worsening of the deficit with the dollar area. The average deficit on visible trade,<sup>3</sup> which was reduced to well below £40 million per month, increased once more towards £50 million per month in the second quarter. The deterioration is explained by a heavy increase in imports, especially in the imports of raw materials. These exceeded the high figure reached in the fourth quarter of 1948 by 25 per cent. The expansion in the import of manufactured articles was somewhat smaller, while the import of food, etc., remained all but unchanged. As manufacturing output has not increased in anything like this proportion, and import prices remained largely unchanged, this indicates a considerable anticipatory buying of goods to guard against the possibility of devaluation. The controls in their weakened state did not seem to have worked satisfactorily.

The dollar deficit increased from £76 million in the third to £96 million in the fourth quarter of 1948. It then fell to £82 million in the first three months of the year and suddenly rose to not less than £157 million in the second quarter of 1949. At this level it is more unfavourable than in any quarter of 1948 and hardly less alarming than in 1947. The loss of gold reserves was £66 million:

<sup>1</sup> Table XII, p. 42.

<sup>2</sup> Cf. below, however, on possible shortcomings of these statistics

<sup>3</sup> Imports c.i.f., exports f.o.b. These figures differ from those in Table VII, which reduced to f.o.b. terms. The discrepancy in import values was roughly 15 per cent in 1948.

the dollar deficit seems to have been twice the rate of the Marshall Aid.

Official explanations<sup>1</sup> attribute the worsening less to direct exports (only £12 million below estimates) than to the deterioration in invisible and financial items (£18 million), and a fall in the dollar receipts of the sterling area (£22 million). If direct exports are further analysed it appears that the greater part of the decline occurred in items the successful sale of which depended either on exceptional shortages in the U.S. (e.g. tractor and car exports declined from a monthly average of over £600,000 in the first quarter to under £130,000 in June 1949) or the demand for which is exceptionally sensitive to income changes in the U.S. (e.g. the export of linen goods fell in the same period from £234,000 to £75,000).

The decline in invisibles, and also the loss of sterling area exports, can be attributed, to some extent, to loopholes in the exchange control. It is also certain that the failure to take measures—either on the international plane or even by the sterling area (possibly in conjunction with Western European countries, especially Holland and France)—to stabilize the non-dollar price of raw materials, contributed considerably to the loss of dollar proceeds. The U.S. demand for these commodities is not sensitive to price, as the price of the finished product into which these raw materials enter is little influenced by the price of the latter. It is also probable that earlier statements of the balance of payments (as they are based on actual receipts and expenditure and not on shipments or the performance of services) have given a somewhat misleading picture of the net movements in the balance of payments. Unlike the U.S., the statistics on foreign balances currently held in London, which originate from current transactions and are therefore convertible, still seem unsatisfactory. The sudden withdrawal of such balances might therefore give the impression of a much sharper crisis than actually threatens, just as their accumulation might stimulate false hopes. The repeated and misleading method of lumping together the sterling area figures in a net sum (as in the case of government expenditure abroad) instead of giving both sides of the account, might hide further loopholes in the exchange control, thus exaggerating the rôle of British current transactions in the sudden worsening in the balance of payments. This is yet another instance of the

<sup>1</sup> Sir S. Cripps in the House of Commons *Hansard*, July 14, 1949, Col. 677-685.

insufficient attention paid by the Cabinet to the political implications of the technical presentation of economic statements and their far too trusting reliance in this respect on their experts.

It is difficult to form an opinion on the nature of unrequited exports which continue to plague the British balance of payments. Detailed statistics are not available. The policy actually followed of permitting the export of capital to the sterling area would be justified only if it could be shown that the investment undertaken was in the short run far superior to any home investment in reducing the country's dependence on foreign aid (and/or in increasing national income). Another equally weighty purpose of a non-economic character would be the grant of drawing rights to less fortunate members of O.E.E.C. under the conditional grants scheme or the repayment of sterling balances to poorer areas. The investment in British-controlled oilfields and in food production schemes in the British Commonwealth represent the first category. The grant of drawing rights and release of some £100 million of old sterling balances in the period July 1948–July 1949 comes under the second heading. Nevertheless, it is doubtful whether the Government has been wise not to establish some control over private capital movements within the sterling area (if only for statistical purposes). The net change in 'old' sterling balances—less than £150 million—of the sterling area countries to which so many writers attributed an overwhelming importance in causing the last exchange crisis, was relatively modest. It certainly does not appear to be greater than what poorer countries, e.g. India or Pakistan, could rightly expect under the circumstances. It is doubtful, however, whether a greater part of the massive private investment of almost £400 million in the sterling area really fell into the two permissible categories. It seems to have been much more in the nature of a capital flight which, directly or indirectly, resulted in the loss of dollar earnings. The indefatigable efforts of the Bank of England to preserve 'freedom'—in however a restricted area—seems once more to have contributed to the defeat of the rightful aim of maintaining multilateral payments on current account within the sterling area.<sup>1</sup> As on many previous occasions—only to mention the

<sup>1</sup> The transfer of capital to South Africa, which came to an end with the victory of Dr. Malan at the polls only, directly diminished gold receipts. Other flight capital soon found loopholes in the regulation of some members of the sterling area and also resulted in absorbing what otherwise would have been dollar receipts

return to gold and the refusal to institute a tight exchange control at the beginning of the war—false considerations of prestige were helping to destroy the real basis of true prestige. The sterling area, the intimate linkage of which with the pound in pre-war times cushioned the unfavourable effects of a depreciation of the pound on the terms of trade, has developed into something like an incubus on the British balance of payments. Indian and South African imports were especially on a scale wholly unjustified by the position in those countries. If British exchange control cannot be made effective in this respect and thus losses of resources occur on account of capital movements and/or if the exchange controls of other member countries cannot be tightened, the continuation of the drain from the sterling area, despite British austerity, may well force the hand of the Government in monetary matters and lead to a devaluation, irrespective of whether economically and politically such a step is justified. It is an intolerable situation that unessential dollar imports by other members of the sterling area should lead to an import crisis and unemployment in Britain. Yet without effective controls only a substantial undervaluation of sterling might stop the dollar drain on account of unessential imports from America, which it is difficult to suppress by price movements alone. Such undervaluation, however, would have unfavourable repercussions on the distribution of income at home, further increasing profits. It might, at any rate in the short run, possibly worsen the direct balance with the United States. A much closer co-ordination of policies of the Commonwealth is needed if the present degree of multilateralism and convertibility, as well as freedom of capital movements, are to be maintained and an effective stand is to be made on behalf of the sterling area in negotiations with the United States and Europe. In any case the Government must reconsider the freedom of export of capital to the sterling area from this country.

We have seen that the Government failed to take energetic measures to increase productivity both by insisting on an adequate expansion of investment and by enforcing a speedy reorganization of production by an appropriate pressure of controls and the establishment of Industrial Development Councils. Indeed, the relaxation of controls in the main resulted in reducing competition. The high profit margin, especially in export trade, might cushion the economy against the adverse movement. But much cannot be

expected from increased productivity in the short run. The lost opportunities have to be paid for, before remedial measures can become effective. At the same time, consumption, especially consumption absorbing scarce resources (and of exportable commodities) increased substantially. Had economic progress been adequate and foreign conditions propitious, the expansion of production—as in 1948—could have possibly carried this burden without worsening of the foreign deficit. As it was, it seems that in the absence of a drastic overhaul of controls only a substantial deflation could have maintained balance. But the Government found itself in a more than awkward position. Revenue of an income character (which had been seriously underestimated in 1948) could not be expected to increase much further.<sup>1</sup> Capital receipts were bound to decline with the end of the liquidation of wartime assets. Expenditure, on the other hand, was rising. Defence was estimated to cost some £67 million more than last year's estimate (though only £6 million more than actual payments). Social services would absorb some £274 million (£50 million) more, despite the limitation of food subsidies. Unless the Government increased taxation, the budget surplus was bound to decline. The changes in the last budget resulted in a net decrease in the revenue of small proportions for the current year (about £20 million), with a subsequent much sharper decline (over £83 million). It should be noted, however, that some of the proposed increases in taxation included in that estimate were subsequently abandoned and that some of the increases in taxes accepted (death duties yielding £11 million in the current, and £20 million in a full year) fell on capital and not on income and were most unlikely to diminish current outlay. It is also probable that a greater portion of total national income was being used for direct social services, e.g. health service, than would be spent if consumers had to pay for these services. This would not in itself be a conclusive argument against the policy pursued as the distribution of income is still unequal enough to prevent adequate health services. On the other hand, the sudden introduction of the scheme resulted in some abuse, not merely by encouraging unnecessary demands for spectacles and dentures, which has received so much attention, but also in an increase of the absenteeism of an unjustifiable

<sup>1</sup> It is interesting to note that taxes on petroleum were not increased despite the growing difficulties of the railroads and the possibility of a substantial revenue.

nature. This is the sound core of the vastly exaggerated charges of profligacy voiced against the Government.

The Government, however, had certainly not drawn the consequences of its earlier policy of decontrol. The estimated overall surplus at £14 million, as good a figure as any<sup>1</sup> to show the orders of magnitude, was £338 million smaller than the actual surplus achieved in 1948-9. No doubt the end of restocking would permit an increase in investment in fixed capital, and the private saving might have increased as the payment of a capital levy was not repeated. It is obvious, however, that the financial pressure was not being reinforced. The reserves of the economy were fully engaged. Only a continuance of a 'high level of demand in the world economy' could justify this policy. At the same time the increase in the inequality of distribution and the slight increase in the cost of living undermined the policy of stabilizing wages. Truly, the Government was tempting to have the worst of both direct and indirect controls. Their close inter-relationship was not sufficiently kept in mind. This had to place the Government in an awkward position if a deflationary pressure should develop in foreign countries, as it should have been discernible in Continental Europe by the end of 1948, and even in America at the time of passing the Budget.

The charges of inflationism and profligacy against the Government thus do not stand closer investigation on the basis of facts. They seem to be derived from hearsay and strengthened by prejudice. Those who make these charges do not stop to consider that a cut in Government expenditure, as we have argued, would not, in the first instance, release scarce resources at all and certainly not increase exports or decrease imports to any appreciable extent. No doubt a sharp dose of deflation, involving mass unemployment and a fall of consumption, would improve the foreign balance—if it did not cause social trouble or unleash an even bigger deflation abroad. In any case it could not stimulate economic progress, which depends on investments and would leave the country basically in an even weaker position than she is at present. Much more subtle means are needed if we are to succeed in compressing unduly high profit margins yet maintain investment, and put selective pressure on entrepreneurs to export. The co-operation of the Trade Unions is

<sup>1</sup> The various alternative estimates all suffer from various drawbacks. Even the most refined does not (because it cannot) take into account the effect of taxation on intended outlay on consumption or investment.



no doubt an essential element in the success of a balanced economy, but it cannot be secured by brandishing the big stick of unemployment. The British problem can be solved only if all are willing to make sacrifice in accordance with their capacity, and if the case against wild deflation can be put over successfully in the world at large. We are clearly in grave danger, as in 1929-33, of falling helpless victims of long exploded fallacies.

(d) THE EXECUTIVE AND PLANNING

The difficulties facing a government pledged to a reform programme amounting to a substantial, if not revolutionary, change in the power-relationships in a country by evolutionary measures are admittedly formidable. The venomous attacks on the policy of full employment and redistribution of national income both at home and abroad, the attempts, hitherto fortunately unsuccessful, to enlist American aid to reverse the verdict of democratic elections, all show the length to which a well-knit and shrewd ruling class might go in the defence of their privileges even in Britain, which hitherto provided a sharp contrast with the Continent. Before embarking on an ambitious and possibly perilous programme of this kind these difficulties must be realized if success is to be achieved. The admirable desire to maintain continuity should not blind anyone to the fact that large-scale changes, however much traditional forms are preserved, raise problems not encountered in more placid periods. Unfortunately a number of factors combined to reduce the effectiveness of the Administration at a juncture when the greatest vigilance and energy would have been required.

The vitality and effectiveness of deliberative government depends on a vigorous interaction between the Executive and the Legislature branch in debate, on the effectiveness of criticism in preventing large mistakes. The public discussion and searching analysis of the problems with which the country is confronted should also secure a positive desire on the part of the community to participate actively in the solution of these problems. Without such a positive attitude the self-restraint necessary to solve difficult economic problems by agreement rather than one-sided political or economic dictation—either by the threat of police-power or that of the sack—can hardly be imagined. Britain at the moment is engaged on one of the most important, if not the most important, socio-economic experiments

ever undertaken of finding higher incentives than naked compulsion or necessity, of combining economic with political freedom. It should be an exciting and absorbing experience, binding the enthusiasm of large masses and providing a sense of exhilaration. And for the success of the experiment nothing less is needed. Can anyone honestly say that, with one or two outstanding exceptions, the Government has succeeded in arousing even the enthusiasm of their own followers?<sup>1</sup>

In the interwar period the rise of powerful party machines, combined with crushing parliamentary majorities, have seriously weakened the control of the Legislature over the Executive. The misfortunes in that period of strong personalities in their relations to their parties are too well remembered to need elaboration. The leaders of the governing party acquired powers over their followers which were not necessarily derived from the excellence of the principles or policies they propounded, but were rather buttressed by the brute force of the machine, which can easily annihilate critics singly. In a more balanced composition of Parliament this would not be possible to the same extent. Parliamentary debate and influence becomes subtly distorted. Personal loyalty to the leaders is encouraged which has little to do with the content of the policies pursued.<sup>2</sup> The weakness of governments elected on the basis of

<sup>1</sup> Is it not interesting that the great success Mr. Priestley had in arousing with his wireless talks enthusiasm and collective determination at the most fearful juncture of the war has not been repeated under the Labour Government?

<sup>2</sup> Public School education might have had some influence in this respect

Cf. also an interesting wartime speech of a back-bench Member of the House of long standing:

'I should like now to refer to the question of Loyalty. I have been loyal to my leaders ever since I have been in Parliament. Perhaps blindly loyal, perhaps wrongly loyal, but, at any rate, loyal, and I still think loyalty is a great virtue.

'I like to judge a policy very largely by the personality of the man who is putting it across. I am absolutely loyal to the Prime Minister and I intend to remain so. There is only one thing that we in the House have to do, and that is to maintain the prestige of the House and the Government. Any man who damages that is making a vast contribution to the enemy's war effort. . . .

'In conclusion, I have not made any important contribution to the Debate, I have not said anything that is new or particularly interesting, and I am going to repeat another platitude. The Prime Minister's position is so tremendous, not only in this country but throughout the world, that any honourable member who tries to nibble away at it and reduce it by any remarks to spoil that position and hurt that prestige, is not only doing a great disservice to this country and to the world in general but is eventually going to bring down upon his head that enormous world-wide opinion which holds that the Prime Minister is the man who matters at the present time and that the privileges of certain Members and the ambitions of certain Members are of no importance at all in comparison with the war effort and with the effort which the Prime Minister is making. He is the only man who can carry on winning this war and bring us peace.'

proportional representation have obscured the grave drawbacks of mammoth majorities usually resulting from the British system.

A further hardly less important factor in reducing the effectiveness of democratic control is the growing complexity of the problems under discussion. Parliamentary control cannot be effective if it is not backed by expert knowledge. The importance of this fact can be appreciated by the evident need for expert briefs felt by those members of the Opposition who have been Ministers. The lack of effective and expert opposition has much increased the danger of failures by the bureaucracy as Ministers increasingly dismiss objections to policy and can sustain their defence against fumbling criticism. The pressure on departments exercised by parliamentary questions is steadily diminishing, further curtailing current supervision of policy by the *Minister* himself. The impatience felt with ill-concerned or obstructive questions has not led to a reconsideration of the mechanics of parliamentary control, but to a limitation of the right to question. Nationalized industries which should be under constant scrutiny have to a large measure been altogether removed from the scope of inquiry.

The problem of declining effective responsibility of the Executive would not be so acute if the character of the Executive itself had not undergone an equally profound alteration. Ministerial responsibility and departmental autonomy are as impeccable doctrines as the impartial loyalty and anonymity of the Civil Service, so long as the problems dealt with are mainly non-economic, and so long as those which are economic are simple and mainly consist in limitations (or at most slight correctives) to individual initiative. As the number and complexity of decisions increase, it must reduce responsible democratic government to a farce. The escape to 'freedom' which some advocate to be able to avoid dealing effectively with this problem is not open to those who believe that that road leads, in Europe at any rate, to misery, inequality and social disintegration. They must face this issue and not be misled, as the Government undoubtedly has been misled, by conventional platitudes.

The first condition of successfully dealing with the problem is a drastic increase in publicity and a limitation of the present complete secrecy to the sphere where it belongs: military security, the need to retain bargaining power in international deals, and the prevention

of illegal speculative gains on the basis of inside knowledge.<sup>1</sup> The present secretiveness which extends far beyond the Government and the nationalized industries is a sign of inferiority, which it must in turn increase. Without vigorous and informed debate and criticism no progress can be achieved. It cannot be stated often and emphatically enough that neither Parliament nor outside bodies with expert knowledge are now in a position to make their full contribution, which is only too patently needed.

Experiments in new forms of parliamentary control, permanent committees, public hearings and a strengthening of the Civil Service at the disposal of the Legislature have always been dismissed with scorn in Britain. The history of war-mobilization—and by no means only in the so-called phoney war period—and of the post-war years demonstrates that this airy feeling of superiority is by no means well-founded. Those who believe that the community organized as a State must necessarily take over functions which a more dispersed organization of power, private firms and individuals, can no longer fulfil, or can only do so at disproportionate economic and social cost, must not take refuge in conventions which were based on the fact that power was dispersed. A strengthening of the advisory permanent staff of Parliament with powers to obtain information for the members of the Legislative, the constitution of standing committees dealing with the current, and not past, conduct of business<sup>2</sup> and, probably, the establishment of permanent expert investigation committees which periodically report to Parliament on nationalized industries and can receive complaints from the public, is probably the minimum required to re-establish the effectiveness of democratic control.<sup>3</sup>

Secondly, steps must be taken to make the basic principles of Government policy operative in a co-ordinated manner on all stages of governmental action, especially in industrial and international matters. It cannot be maintained by even the most favourable critic of the Government that their efforts—if any—in this respect were

<sup>1</sup> Even in these cases, however, means ought to be found—possibly by extending the Official Secrets Acts over members of certain parliamentary committees—to restore some control.

<sup>2</sup> Cf. 3rd Report of the Select Committee on Procedure (1945). Meetings of such Committees should be held *in camera* to obviate temptation to use the occasion for political vexatiousness and sensationalism.

<sup>3</sup> Periodical Royal Commissions might also play a rôle. But in their case the natural play of checks and balances, which ensures in legislative committees effective supervision, cannot be counted upon. Hence the choice of personnel is of the gravest importance.

successful. To some extent this was due to the fact that the present Government issued from a Coalition Government in which the representatives of the minority party, Labour, loyally co-operated in a policy which was, not unnaturally, mainly determined by the Conservative majority. As the latter were in favour of the *status quo*, this meant that 'controversial questions,' questions of change, were left as much alone as possible. So far as the main task, the winning of the war, was concerned, differences of opinion were not those of principle. In any case Mr. Churchill's ascendancy was decisive.

The grave consequence was that the divergence of attitude between the political and permanent personnel of the Executive was largely hidden. The tradition of 'impartiality' was accepted, as it could largely be accepted on non-controversial issues, during a fateful war. Once the political battle was joined this heritage of policies and policy-makers became ominous. Ministers are not, with certain exceptions, experts on questions concerning their departments. It has been shown that this has advantages. A fresh mind, in touch with political trends, will be much more likely to give appropriate decisions in matters which affect the public. Their feel of the possible must be more acute than that of the expert, or the administrator. In those cases, however, where an expert happens to be at the head of a department, he is necessarily overwhelmed by daily work, and cannot follow questions of detail on the basis of all available data for himself. Thus in order to be able to give a decision in full accordance with the declared long-term policy, a Minister must have accurate information of the alternatives as *he* would see them, on the basis of *his* principles, and not those of others.

Once the differences in the basic political and social principles between political parties are acute, the grave danger will arise that the majority of the higher officials might be out of sympathy with the views of the government in being. If these officials, as has happened in Britain, have been nurtured on ideas and ideals in violent opposition to those of the Labour Government, frustration and failures are certain. However loyally they might strive to implement policy, they are bound subconsciously to present problems from a point of view different from the origin of that policy which they are called to implement. A slight bias in setting out issues, an almost imperceptible but cumulatively important hesita-

tion and admonition to caution, might vitally affect decisions. The intellectual background of most high civil servants makes them, in most cases, unable to see problems in quantitative terms. The recruitment, especially in the past, favoured men of classical education, dialectically skilled rather than those who are inclined towards a constructive and analytical approach. Recent changes have done little to remedy the defect or to ensure that the administrator at a later stage of his career should be made systematically aware of the social implications of his administrative functions. The reorganization of the Civil Service under Lloyd George (with the intention, apparently, of making the Service more efficient) which makes permanent secretaries, like ministers, flit from department to department and tend, therefore, also to be inexpert in the details of the problems with which they have to deal, has not increased the sureness of touch in carrying through reforms, or gauging their effect on other parts of the system. The system of promotion did not much favour energetic or progressive minds.<sup>1</sup>

<sup>1</sup> It is interesting to recall that during the war temporary civil servants made remarkable careers despite the continued efforts of the 'regulars' to keep them under control. It might not be out of place to quote from a wartime study on the problem of the influence of personnel on policy prepared for a parliamentary group formed to press for an increase in the war effort:

'Yet, criticism from outside can in no way serve the purpose. The answers in Parliament show how futile, if not dangerous, criticism is, unless it leads to a successful change of the system itself. Ministers, past and present, sincerely believe in their success in solving the problems, and they must, in order to secure the loyalty of their staffs, be loyal to their staffs, quite apart from the fact that otherwise they would condemn themselves. Each of their subordinates in his turn invests himself (at least for debating purposes) with the same cloak of infallibility. Each Minister must be able to show magnificent results, whether they in fact exist or not. This necessarily results in a certain lag in remedying blunders and altering policies. The denial of a problem, the non-admission of a fact, becomes more than Parliamentary tactics, it becomes by a strange necromancy the fact itself. The advantage over the Dictators which springs from fruitful criticism is thereby much reduced, and the handling of the Official Secrets Act, calculated to render informed criticism impossible, plays more into the hands of the enemy than it hinders him by obstructing his intelligence service. Ministers thus tend to be the first to be persuaded by the publicity on which their reputation is built and attach undue importance to their Publicity Experts. It is not without significance that Public Relations Officers seem now to be the only Civil Servants who faithfully follow their masters in their peregrination in the game of "Musical Chairs." Indeed, these experts in mass-reaction seem to exert some influence on policies—not altogether to the advantage of the country in times when unpopular measures might be necessary.'

The Departments which have to prepare the answers to any embarrassing questions asked in Parliament will take care not to give themselves away, even at the cost of misleading indiscreet interrogators. The Public School spirit triumphs. The Minister cannot be an expert in the manifold offices to which the political storms of the past years blew him. He cannot, in most cases, judge for himself. He is, in many cases, also misled. Many instances can be quoted: one of the most blatant is the problem of Foreign Exchange Control. Sir John Simon, in March 1940, assured the House that the pound was not unduly depreciated at the outbreak of war. In June 1940 the pound was revalued. He refused stricter control.

In departments where the problems are clear-cut and the handling of policy easy to supervise, that is, mainly the spending departments concerned with social services (or even with tax measures), and where the problems can be solved by legislation, Ministerial responsibility is still a valid principle. But the most important problems are not of this character.

Unfortunately it is exactly in these fields of administrative action, of planning and co-ordinating, that the Labour Movement has always been at its weakest. The problems of industrial policy are complicated by the traditions of Trade Unionism which favour

He assured the House that no financial considerations limited pre-emption or other parts of the war effort, since then it has become well known that the Treasury exercised, in the first seven months of the war, an unfortunately effective control on purchases of war material in the United States and in the Balkans. Sir John Simon also assured the House that the losses due to the loopholes in the control of Foreign Exchange were negligible. Mr Morgenthau's figures quoted above show that the actual loss was almost £100 millions.

'Much the same had happened in the Services. Initially handicapped in contrast to countries such as Nazi Germany, Japan or even Russia, in the selection of man-power on which to draw, the system killed all initiative there was. Liddell Hart (*Defence of Britain*, Chapter 19, p. 138). "Preference was given to the officers of the older arms (in promotions) who were immune from suspicion of dangerous thought," and he continues, "It was the most certain way to convince the most keen men that it (the army) was still an unpromising career for men of ideas. Further, it was likely to convince the younger men already serving that it was still 'unhealthy' for them to take up any of the newer lines of service or to become known as progressively minded soldiers." Consequently (page 374) in the tactical sphere the tendency "to adopt an inadequate inner compromise has been still more marked" and he adds that "numerical superiority still counted much more than equipment. One of the chief experts on Tanks when promoted was sent to India to command an unmechanized division. Another was transferred to Anti-aircraft, whilst a third was given the administration of barracks. When the first mobile division was formed a gunnery expert was appointed to head it after a driving instructor having been seriously considered for the appointment."

The 'modern' method of recruitment which uses 'psychological tests' has aroused much controversy. Its really important consequence, which, significantly enough, has completely escaped notice, is that it has in fact resulted in the exaggeration of the importance of the interview as compared with written intellectual tests. It must therefore be regarded as a dangerously retrograde step which permits a much wider range to personal prejudice and nepotism than the old competitive examination. The educational standards, especially in the Foreign Service, might be neglected in the determination of selections. Cf the scathing minutes of Mr. Churchill on the practical implications of the interview system in the contemporary British setting. *The Second World War*, Vol I, Appendix II, pp 608-10.

Cf. also the comments on the State Department by a wartime collaborator of President Roosevelt:

'Stettinius, at Roosevelt's direction, made a determined effort to reorganize the State Department and bring it up to date. He drew up an enormous and impressive chart with myriad boxes in orderly array. But he found out that this rearrangement could produce no real change in the character of the State Department as long as the occupants of the boxes, particularly on the upper middle level of divisional chiefs, remained the same, and they did remain the same, for these were the permanent career men who knew that they would still be there when the Franklin Roosevelt Administration had been replaced by another one, which might well be reactionary and isolationist in accordance with the inexorable ebb and flow of American politics, and they were determined to keep their records clean of New Deal or One World taints against that highly possible day.' *The White House Papers of Harry L. Hopkins*, by R. E. Sherwood, Vol II, p. 753.

tripartite negotiations tending towards corporative solutions hardly compatible with stability or efficiency. It has always regarded problems arising out of power and force, that is, questions of international dispute, with distaste, and tended to dispose of them by formulae such as peaceful arbitration and collective security and the like, which do not stand dispassionate analysis as practical norms. It could never quite resolve the contradictions between its domestic aims and its policy in international relations, including relations with the Colonies. Nothing could be more dangerous than a combination of ambitious commitments in foreign affairs and social betterment, of socialist consumption policies, which might be very costly, with a failure to pursue ruthlessly industrial reorganization and increase production so as to create the capacity to sustain the burden. Yet this is the most likely outcome of the combination of definite social aims with hazy and often contradictory views on production and international policy.

A greater part of the failures which have been discussed in a previous chapter can be traced to this source. It is impossible in this paper to relate this inability to its various social causes. The tendency of Ministers to rely on their Civil Servants is natural. It is increased if the Minister, for one reason or another, feels insecure in facing his subordinate, or is specially flattered by his attentions. Memoirs concerned with the history of previous Labour Governments have emphasized the importance of this fact. It does not appear that it has completely disappeared yet. In any case the pressure of daily business is such that choice of their chief advisers becomes of the utmost importance. It is noteworthy that the two most powerful Prime Ministers whom this country has known in this century both had a large personal staff, mainly, if not entirely, recruited from outside. Without some such arrangement there is little chance that the whole field will be surveyed, all alternatives explored and, above all, that executive action will be supervised in the spirit required.

This personal relationship is the more important because the career of a regular civil servant is only partly (and to a lesser degree than before the reform) dependent on his political chief. Young men in a hurry, with 'wild' ideas, will see themselves rapidly excluded from the approbation of those circles where reputations are made. When outside tests, the failure of policies, show up the hollowness of these reputations, at worst promotion follows in



order to sustain 'face.' A department can do no wrong. There is to be no victimization—except for the victims of the policy. Changes in personnel, analysis of past mistakes is not a form of scapegoat hunting but an essential preliminary to changes in policy. No vested interest is so tenacious and therefore dangerous as the intellectual one. Evasive formulae so dear to public life should at last be recognized for what they are. The tribal taboo which condemns as unfair all criticism of the constitution and leanings of the chief body of policy-makers in the state cannot be sustained on objective analysis. Its consequences on shaping policy are frightening.

At international expert committees Britain is often represented by people who spend their time at home in denigrating the policies and efforts of the present Government. On international economic matters vital decisions in its first years were based on advice of economists who are bitterly opposed to the aims of the Labour Party. It is not, it seems, realized that economics is a normative science in which 'non-political' statements might often cleverly cloak violent prejudice. The unimaginative approach to the Marshall Aid problems at a time when the U.S. was in a favourable mood, the consequent diplomatic isolation of this country in O.E.E.C., the half-hearted and sceptical handling of the relations with O.E.E.C. which must have contributed to U.S. disillusionment, these and many other difficulties are to a large extent due to the fact that policies are influenced by many who fundamentally dislike and distrust anything but the orthodox approach.

In Germany, the fatal policy first of financial chaos, incompetent control and the discouragement of Trade Unions,<sup>1</sup> and subsequently of the iniquitous currency reform, was not due entirely to U.S. dictation, as it is often suggested, though the U.S. has by now acquired complete ascendancy and seems to justify these complaints. Nor was it due to wartime mistakes in policy or the Potsdam Agreement. At times the U.S. was willing to entertain comparatively enlightened plans, for example, the Colm-Goldsmith report. The currency plan as adopted and the subsequent deflationary policy were influenced and encouraged by the British Authorities.<sup>2</sup>

<sup>1</sup> One provincial bill requiring the assent of Trade Union officials to the movement of goods which could have checked black-marketeering was disallowed by the British Military Government. The law nationalizing the heavy industry of the Ruhr was equally vetoed on the most flimsy pretext.

<sup>2</sup> Cf the approval given to the scheme by Sir Cecil Weir in an address on 'Economic Developments in Western Germany' (*International Affairs*, July 1949) Sir Cecil Weir, until

Wherever British influence counted in shaping policy, e.g. during the war in India, afterwards in Greece, in Central Europe and elsewhere, the same type of old-fashioned *laissez-faire* approach is discernible. It has cost this country hundreds of millions of pounds in inflated war-debts or unrequited aid, without achieving any purpose. Yet the causes of the failures are not carefully investigated, nor steps taken to prevent their recurrence by a careful selection of experts who understand the reasons for, and merits of British domestic economic policy.

In the serious military, diplomatic and economic crisis of the British Middle-East policy which is now clearly admitted on all sides,<sup>1</sup> it is the intellectual failure which is perhaps the most appalling. Political and moral conceptions might be changed on the political plane, but the frightening aspect of the experience is the incompetence of the instrument of execution. Relations with the Eastern European countries might not have had a chance; but there, again, the consistent disregard by the British representatives of the centre parties—now unhappily defunct—was a factor of grave discouragement to the true friends of Britain. In Colonial matters there is also a wide discrepancy between the excellence of aims and the tactless, unimaginative, haggling, niggardly and belated execution on the spot. It took three years to call a Colonial Conference which proved a real psychological success. The usual pattern of a sequence of refusal of demands, followed by commotion, and ending in unrequited concessions, has hardly been broken.<sup>2</sup>

In domestic matters the position is equally disturbing. The recently the British President of the Economic Sub-commission of C C G, does not seem to be aware of the social and political consequences of the policy pursued, nor of the fact that it was exactly the opposite of the domestic policy pursued by the British Government.

Several of the most important members of C C G who resigned and returned to this country have immediately actively attacked the Government's domestic policies.

The following report appeared in the *Continental Daily Mail*, September 9, 1949, of an article written of Lieut.-Colonel Patrick Miller, who was formerly on the British staff in Germany, in one of Germany's leading weekly papers, *Die Zeit*, published in Hamburg (of September 8, 1949):

"The Labour Government, he says, is carrying out dismantling in order to hinder German competition, not in the interests of British businessmen but in order to protect its Socialized industries

"Germany to-day can produce more cheaply than Britain," says Colonel Miller "The reason for this lies not in the system of private enterprise but in the "welfare State" of the Labour Government, whose sole effort is directed at raising wages and increasing leisure " It should be added that the periodical was then still under British control. No comment seems needed.

<sup>1</sup> Cf. *Economist*, July 16, 1949, p. 115.

<sup>2</sup> Cf. the Report of the Select Committee on the failure to evolve coherent economic plans for the colonies. The lack of any stabilization scheme for colonial produce has seriously aggravated the dollar crisis.

administrative machinery has not been reorganized to conform with the change of policy. There seems to be no realization that the spirit of legislation can be frustrated by the day-to-day approach and influence of the administrators, even if, as we said before, they believe that they are loyally carrying out the orders of the Government. Is it not significant that the Bank of England still seems to pursue the false quest of monetary prestige and to be reluctant to tighten the mesh of exchange control though the flight of capital, facilitated by the still legal export of capital to the sterling area, is among the main reasons for our monetary troubles?<sup>1</sup> And is the unopposed rise in the rates of interest not indicative of the power of pre-war financial prejudice?

In four years of the present Government's office there has been little attempt (apart from steel) to reform the controls over industry so as to render them capable of enforcing efficiency which the market mechanism was incapable of doing because of monopolistic restrictionism. The considerable increase in profits,<sup>2</sup> due to the methods of fixing allocations and prices, seems to show that controls are almost indistinguishable from cartels. Controls which might encourage efficiency go by the board. 'Voluntarism'—the self-control of vested interests by voluntary compacts—which is as horrid a word as it is a muddled concept, is encouraged. What can the result be but sluggish vegetation? A thorough public investigation of the problem of controls is called for by experts who are aware of the permanent role of controls in a mixed economy and therefore wish for their reform, not abolition.

In the First War, Lloyd George tried to establish a system of excluding the vested interests from controlling themselves; this example has not been followed. Since the inception of controls under Chamberlain a kind of self-government was established and this odd anomaly has not been changed since. The ill success of centralized buying, the importance attached to short-term advantages instead of using bulk purchasing for strengthening the long-term position of the country (by promoting the increase of supplies)—these are some of the mistakes which were to a large extent due to this system.

<sup>1</sup> Cf. Mr. Bevin's attack on the Bank of England, House of Commons, February 13, 1946, Col 400/1.

<sup>2</sup> Cf. Barna, *op cit*. After ten years of control no authoritative report has appeared on this vital topic

Nor is this a new problem.

'These are specific points arising out of the export problem. But behind it all remains the unsolved question of total-war organization. As a sample of the whole war-economic organization, the history of our foreign economic war policy presents a melancholy picture of delay, lack of imagination and lack of initiative. The Government (and in this very complicated field, as in others, this exclusively means the Civil Service) were unable to free themselves of their peacetime prejudices, were unable to analyse afresh the new problems which were thrust on them by the war and which they could not escape. They resisted all change. They denied that problems existed. They countered criticism by statements as complacent as they were misleading. Finally, when they were driven in a sector to accept their critics' policy, in their fundamental resistance to that very policy they robbed it of most of its merits by a continued lack of imagination and planning.

'The outworn divisions between the functions of Departments clearly demand an early review. It seems hardly tolerable that matters which are inherently interconnected and which demand unified decision and specialized expert knowledge, imagination and initiative should be dealt with by two or more Departments, the permanent staffs of which, and more especially their Senior Officials, are overburdened by other tasks and, owing to their peacetime traditions, have divergent outlooks and methods of approach, and that an uneasy compromise should then be laboriously worked out. It is useless to blame Ministers who cannot in the nature of things be expected to know the background of the problems or to form an opinion on the soundness of the solution. There is a basic conflict to-day between the facts of the position and the constitutional fiction of Ministerial Responsibility for which a solution must be found.

'A system in which the concept "administration" is separated from, and in most cases opposed to, "theory," in which "intelligence" is not equivalent to "action," seems to suffer from grave handicaps when confronted with a system in which central planning is made elastic by decentralized execution.'<sup>1</sup>

These sentences were written to sum up the Treasury's foreign

<sup>1</sup> 'The drift towards a rational foreign exchange policy' *Economica*, August 1940.

exchange policy during the phoney war period, which cost the country the better part of £100 million in dollars and the accumulation of a vast sterling debt to India. How often could these observations have been repeated during and since the end of the war? So long as the basic principle remains that a gentleman can effortlessly handle any problem, so long as Old Buggins must have his turn and Old John his job, Britain's difficulties are not likely to diminish. Between the lust for purges to which the Communists seem to have fallen helpless victims, and the failure even to realize that the executive must somehow be made positively effective, some compromise should be possible.

All this may not be serious in each instance. A resolution of an obscure committee of the United Nations adverse to the policy of the British Government; a sharp attack in a report of the B.I.S., which is partly owned by the nationalized Bank of England, based on long exploded fallacies; the spread of unemployment in Western Europe, might not each have an immediate catastrophic result for this country. Cumulatively they have rendered the position of Britain equivocal and difficult.

There are valid arguments against disrupting the corporate existence of the Civil Service by changing all higher officials, as usually happens in the United States whenever there is a turnover of parties. But there can have been few examples in history—such as perhaps Mr. Roosevelt's second term—when the cleavage between those in power and those in powerful intellectual and economic or social positions was as complete; there is no parallel to it in which so little was done to buttress the position of the ruling majority and secure its own élite. If the Government believes in its approach to the great problems of the country and the world, it must try to secure hearing and respect for it, and not try to borrow respectability from its opponents. It has succeeded in neither. Nor should respectability be confounded with conformity. One is almost tempted to paraphrase Lord Keynes: 'a "sound" (man) alas! is not one who foresees danger and avoids it, but one who, when he is ruined, is ruined in a conventional and orthodox way along with his fellows, so that no one can really blame him.' It is probable that the wish not to alienate 'respectable' public opinion and maintain national unity has played an honourable rôle in this muddle. If so, it has had ill success. Charges of political nepotism are rife. Yet an

analysis of the composition of the most important Government boards and even committees of inquiry shows a majority opposed to the Government, only lightly relieved by Trade Union representatives.

Many things have changed in Britain since before the war. The one solid factor which threatens to remain with us is the refusal of the entrepreneurial classes to live by competition instead of by compacts; and the amateurish and slightly flippant approach of the bureaucracy to vital questions. In former periods Britain paid for this in terms of unemployment and a low standard of life. Now, when socialism has been victorious with respect to consumption and social services, we pay for it in terms of periodic crises in the balance of payments, unexpected by all who should know about it first. We may yet be forced to revert to the former method of payment, spreading deflation still further. So long as the fundamental cause of the malaise is not remedied, it will break through from time to time, however generous international agreements may be concluded.

The minimum requirement as an interim measure is to revert to the well-proven system of such statesmen as Lloyd George and President Truman and assign to all important Ministers a staff of experts who are not members of the Civil Service, but who act as his advisers on long-term policy and see that the spirit as well as the letter of his instructions and policies is carried out. An inquiry on the methods of recruitment and further training of Civil Servants should also be undertaken without further delay. It is essential, however, that those who believe in planning should be adequately represented on the committee appointed, as otherwise we shall only get yet another report shirking contemporary problems. Finally, the statistical and intelligence services of the Government must be strongly reinforced and steps must be taken to secure an adequate opportunity, especially on the wireless, for unorthodox views on current economic problems. Freedom of speech must be made effective.

Appeals and exhortation without effective reform of the administrative machine will not secure the increase in efficiency and investment that is needed. Nor can we succeed by squinting hopefully towards the uncontrolled play of the price-mechanism. The massive experience of war economic mobilization and of the inter-war period give an unequivocal answer in this respect even if the horrid

example of the Continent is disregarded. A new system of quickly-effective incentives and deterrents must be found if Britain is to regain her economic balance without grave hardship. Before Britain will be in a position to approach others to collaborate, it must put its own house in order and prove that it is worth collaborating with.

## CHAPTER 6

### BEYOND THE MARSHALL PLAN

#### THE AIMS OF WESTERN POLICY

IT is quite clear that we have reached a dangerous turning point in the relations of the Western countries. This is to some extent due to the fact that dangerous illusions have been promoted about the character of the Western European crisis, and they are being shown up for what they always were. But disillusionment does not promote will to sacrifice. Moreover, the decline in U.S. business activity, which renders the need for help greater, and the willingness less, coincided with a slight reduction of the international tension, due to a more reasonable attitude by the Soviet, which further decreases the emotional pressure behind U.S. co-operation with Europe.

In earlier chapters we have come to the conclusion that the fundamental economic weakness of Europe, which is of long standing, is not a problem which can be eradicated quickly, by a once-for-all operation. The productive unbalance between the Western Hemisphere, but especially the United States and Europe, is of a dynamic character, due to the higher rate of economic progress in the former, combined with its natural self-sufficiency, buttressed by protection. Because it is dynamic it will re-create itself periodically, unless some new equally dynamic counter-balancing factor is introduced into the Western economic system.<sup>1</sup>

From what is sometimes rather oddly termed the 'economic' point of view no 'problem' exists. If we disregard relative standards of life, and the possibility, indeed probability, that mass unemployment and starvation may well ensue if conscious measures are not taken to promote a more even international distribution of wealth and income, 'equilibrium' in the sense of a balance of payments is perfectly easy to produce with or without devaluation, with or without 'controls.' 'Freedom' of trade could also be re-established in Europe. Perhaps even capital movements could be permitted freely without any blocking of pre-'liberation' financial claims.<sup>2</sup>

<sup>1</sup> Cf. below, Appendix, 'The concept of a dollar shortage'

<sup>2</sup> Thus, as in Germany, shifting the burden of readjustment away from the owners of real assets



Provided monetary demand is appropriately reduced by raising the rate of interest sufficiently<sup>1</sup> and reducing Government expenditure by cutting social services and State-initiated investment, causing mass-unemployment and an abrupt fall in the standard of life, external 'equilibrium' without controls could certainly be re-established.

All this can be freely admitted. Nor is it open to doubt that the United States could enforce almost any policy for a time—even without recourse to more forcible means, by economic pressure alone. The question is what the cost of the exercise would be, first to Europe, and subsequently also to the United States; and whether there are any moral arguments in favour of this policy.

A nasty medicine need not be the most beneficent, the Victorian convictions of its proponents notwithstanding. Only if it could be demonstrated that Europe would benefit *relatively* to the United States, which is by far the richer community, and one which did not suffer from war devastation, would there be an ethical basis for this approach. References to 'liberty' and 'equality of treatment' sound hypocritically hollow in this context. The Nazis, when howling for 'freedom' in the days of deflation and appeasement, were really demanding power to dominate.

Now, as we have shown, 'non-discrimination' and convertibility would—*ceteris paribus*—at least in the short run result in a sharper deflation, unemployment and lowering of the standard of life than would be necessary if more selective methods were used. In so far as Europe in any case remains on the brink of dangerous social commotion, an attempt to enforce the orthodox 'rules of the game' would be dangerous, even if the United States were fully employed. An attempt to achieve a forced dollar balance would run counter to all sound canons of international economics and would result in an unnecessarily restrictive bilateralism of the worst kind (i.e. of the kind which brings about a balance of trade between pairs of countries) and a sharp fall in the standard of life of Western Europe, based as it is on converting raw materials and foodstuffs into products of high specific value. And if single European countries tried to close their own dollar gap and restricted imports from each other in the hope of not losing 'gold or dollars,' the series of haphazard stopgap

<sup>1</sup> In certain Communist-dominated countries, e.g. Hungary, internal (not external) control was attempted by monetary means alone, prior to the phase of confiscating factories, etc. The rate of interest rose above 15 per cent.

measures of 1947 would be elevated into a sort of *sauve qui peut* bilateral restrictionism. The alternative is a cumulative deflation leading to a 'complete chaos. Only as long as there are countries which accept, for example, Belgian exports, can Belgian unemployment be kept even at the present shocking level of some 15 per cent of the working population, and Belgium enjoy a surplus in her trade. The adoption by others of the Belgian policy now so heartily commended by some 'experts' would soon lead to a spiral downwards from which Belgium would not be exempt. The shocking experiences of the 'gold bloc' of the 1930s, not to mention the fall of the democratic Weimar Republic, originally the staunchest advocate of deflation, should be a warning.

But even *sub specie aeternitatis* little can be said for the orthodox arguments. They consistently neglect the consequences of their proposals on the international distribution of wealth and income. And there can be no doubt that they would increase inequality. They would make the richest country certainly richer.<sup>1</sup> Whether they will actually make the poor poorer is not so certain.<sup>2</sup> But even in the more distant future it is possible to imagine so large a superiority in U.S. technical progress over Europe, as to turn the terms of trade sufficiently against the latter to cause an actual *fall* in the standard of life. In any case, most of Europe's efforts to raise herself might be perpetually stultified by this pressure on the terms of trade even if her standard of life did not actually fall. At the same time the growing difference in relative wealth would undoubtedly tend to increase the instability of the United States, thus leading to periodic sharp crises in the peripheries. 'Readjustment' in these circumstances would undoubtedly necessitate a sharp reduction of the average standard of life, whether through unemployment or a general decrease of wages (e.g. through devaluation). The political consequences on the cohesion of the Western world and on the stability of its institutions would be fatal, even in the more favourable case.

These considerations rule out the various, often ingenious, schemes which propose once-for-all injections of dollars into the Western

<sup>1</sup> The 'riches' might, of course, take the form of enforced leisure, i.e. unemployment, with less than proportionate fall in the standard of life.

<sup>2</sup> There can be no doubt that this would be the case *at present*, especially if the U.S. Government were prevented by orthodox propaganda from taking measures to arrest and reverse the present downward trend at home.

system, the magnitude of which is estimated on a more or less arbitrary basis. This limitation, this *fixity of means*—quite apart from their total insufficiency—contrasted with *continuity of needs* was the fundamental ground for holding that the Bretton Woods agreement and the U.S. loan agreement did not provide a satisfactory solution to our problem. The suggestion, e.g. that the blocked sterling balances accumulated during the war should be taken over by the U.S. and sterling then made convertible represents a palliative of this kind. It would also be exhausted by the relentless pressure of American competition.

It is this limitation in time, and the fixing of the size of E.R.P. on the basis of *present needs*, given *present monetary and industrial policies*, instead of inquiring how much investment and readjustment is required to sustain a given standard of life, and planning accordingly, which has caused the present disillusionment with the Marshall Plan. It is most regrettable that the failure of O.E.E.C. to plan effectively, to go beyond and behind the national 'plans,' has led to a break with the original concept of the Marshall Aid of restoring European productivity sufficiently to avoid a dangerous lowering of the standard of life.

Admittedly the problem is as novel as it is formidable. Rich and poor nations co-existed before, just as rich and poor lived side by side in national communities. The growing social conscience within national territories has led to the elaboration of a complex system of progressive taxes and the establishment of social services to relieve injustice and inevitable social tension. This development was not paralleled in the international field. The divergence in the standard of life of various countries and continents continued to increase, only somewhat mitigated by emigration. The flow of capital had a more mixed consequence. On the one hand it tended to increase the revenue of the rich further; on the other it undoubtedly assisted under-developed areas, especially when it was in the form of loans carrying relatively low rates of interest. The frequent defaults on both public and private foreign loans also had a redistributive effect.<sup>1</sup> But in general it is true to say that no demand for one-sided help based on human compassion or moral duty has been voiced before General Marshall expounded his plan or Presi-

<sup>1</sup> In view of the continued Malthusian danger in a large part of the world, it is difficult to see, moreover, how a lasting improvement in the standard of life of areas of large population increase could be brought about.

dent Truman propounded, as the fourth point of his inaugural speech, the need to help consciously and *as a free contribution* the less fortunate parts of the globe.

It would be calamitous if exclusive preoccupation with the need to resist Russian encroachment, however justifiable, would obscure these aspects of the European, indeed the world, economic problem. It is, indeed, more than likely that the American internal economic position will worsen sufficiently to cause serious upheaval elsewhere even before Marshall Aid ceases. The discrepancy between American productivity and that of the rest of the non-Communist world is so great that a relatively small decline in the U.S. might strike like a tornado elsewhere. A return to the time-honoured orthodox remedies of economy, cuts in expenditure at home and on foreign aid coupled with an insistence on non-discrimination and the abolition of quantitative controls would undoubtedly smash the beginnings of European recovery. Nothing would promote the spread of Communism more certainly than this sequence of events.

Viewed from this angle, the purpose of U.S. help should be regarded as first enabling Europe to undertake an intensive investment programme and initiate the organization of an effective economic unit in Europe and, subsequently, promoting equally far-reaching development plans in overseas countries. Thus the problem of the present growing international inequality of wealth could be mitigated and at the same time the United States assured of stability. The greater U.S. help now and the larger the U.S. aid or foreign investment subsequently, the more easily can the world return to the pre-war pattern of multilateralism, and the less necessary would be discrimination to obtain the same degree of international redistribution of income, because the easier will the U.K. find it to provide dollars for sterling and *at the same time* refrain from limiting imports all round. There is no doubt, however, that it was on the convertibility of sterling—even if controlled—that the pre-war pattern of multilateral settlements depended.

Clearly, then, we should make a reassessment of the long-term aims of Western policy and arrange detailed policy measures accordingly, instead of elevating prejudices in favour of certain means (i.e. *laissez-faire*) to be the aim of all policy, irrespective of its human consequences. Much has to be done even in this respect. It is easy to criticize the naïveté of those who wish to bring about a

'unification' of Europe. It is equally facile to prove that retrogression towards the theological cant of non-discrimination, convertibility, coupled with deflation and devaluation, and followed by hopes of restoring private investment, would in fact lead to an economic breakdown involving a fatal weakening of the will to defend or even to maintain democratic institutions in Western Europe. The weakening of the cohesion of Western communities might not cause civil war. But even sullen decay of the evolutionary Labour movements would, without any doubt, fatally weaken the power and the potential military value of Western Europe. It would not be difficult to demonstrate that in many Western countries it was more the revulsion from the intolerable indignity and insecurity of life for the individual under Communism, than positive conviction of the certainty of progress under Democracy, which consolidated a majority of the Western nations in their resistance against legal or illegal advances of the former. How far are we to trust a negative factor?

A much more positive approach is essential if Europe is not to suffer from that moral disintegration which paralysed most Continental countries in their resistance to Fascism and Nazism.

It is in this respect that American policy, or rather prejudice, has much to answer. In almost all countries—though not in Britain—the American representatives have, despite vehement criticism from better-informed quarters, pursued a policy of appeasement and aggrandisement of circles and interests which had not, even in all cases, been on the side of the Allies in the war and whose lack of constructive conceptions were responsible for the general breakdown in Europe after 1933.<sup>1</sup> It is shocking to see people whose lack of judgement, or worse, was responsible for so much suffering and damage, now again raising their heads, and once more putting forward policies which lead to social and economic disintegration.

The main safeguard of the strength of the Western conception of political organization must be looked for in the establishment of a more balanced community in which the power of the purse and the sack would not reduce the majority of the population to an

<sup>1</sup> Cf the excellent survey of this aspect of the problem as seen by an expert U.S. observer, Professor Galbraith *Beyond the Marshall Plan*, National Planning Association, 67, esp. pp. 11–16; also Professor S. Harris, *The European Recovery Programme*, Harvard, 1948, pp. 74–5. Unfortunately the representatives of the British Government only too often associated themselves or even took the lead in this respect.

inferior status and thus vitiate political democracy. Nor can it be expected that this dichotomy could persist for long. Once the majority understands that employment and the distribution of income can be mastered by collective action, just as natural resources have to a large extent been subjugated, this halfway-house will be menaced. Those who have savoured the Keynesian knowledge will no longer bow to orthodox myths. Either the adult vote has to be abolished—or tamed—or equality of opportunity granted. This is particularly certain in Europe, which has no comparable resources to America, where opportunities are rarer, and class structures more rigid, and where, above all, the historical basis of privilege has been undermined by incompetence, sluggishness and, on the Continent, by corruption and collaboration with the totalitarian enemy.<sup>1</sup> Anti-Communism, like patriotism, is not enough.

First and foremost, therefore, we must reconsider the fashionable views on the nature of the Communist threat. This is dominated by the rise of the Soviet Union to the position of military predominance on the Continent of Eurasia, and the consequent, almost panicky reactions in the West which promoted quick military and political agreement, leaving basic economic and social differences unresolved. The political agitation needed for the successful conclusion of the Atlantic Pact, in the passing of the Military Aid measure have all contributed to the prevailing confusion, which prevents effective action in other directions.

The fact cannot be strongly enough emphasized that Communism *outside* the military confines of the Soviet is a reaction of desperate masses to economic subjugation and social injustice which looks to the Soviet Union for liberation. This conception of the character of the threat, however, forces a profound alteration in the policy of defence as at present conceived. No doubt Communism must still be regarded as aggressive. But the nature of the aggressiveness is no longer confined to threats of, or even preparation for, the use of force. However misguided we might regard the protagonists of the extreme Left, we must accept that we are confronted here with

<sup>1</sup> The fact must be strongly emphasized that the European economic system and social background differ so much from those in the United States that conclusions based upon the analysis of one cannot be applied to the other. Investment capacity in the United States, for example, is so vast, technical progress so quick, the agricultural man-power 'reserve' still so considerable, that the elasticity of the system, even without unemployment, ought to suffice. Unfortunately, little attention is paid to these differences in many of the current controversies.

a *super-national* movement which originates *within* national communities and does not (as the Quislings did) depend on the existence of the Soviet alone. We might think that the movement is manipulated in the interest of Russian nationalism and imperialism; but it will prove impossible to prevent its spread, if the social and economic causes are not eliminated which led to the rise of revolutionary movements already prior to the establishment of the present system of governance in the Soviet Union.

Nor must the solid economic achievement of the countries under Communist domination and its influence on the attitude of broad classes in the West be under-rated. The Eastern European countries have not merely been the poorest before the war; their economy, if not stagnating, was developing relatively slowly and they were, with the exception of Czechoslovakia, in the grip of ruthless dictatorships which enjoyed the support of those circles which now seem to be the staunchest advocates of political and human liberties, including the Catholic Church. They were shattered by German occupation, guerilla warfare, air-attacks and the land-fighting antecedent to their liberation. In comparison with Western Europe they started with handicaps hard to imagine by the population of the less unfortunate areas.

The determination of their Governments, and the successful mobilization of their populations for the work of reconstruction has already achieved formidable results. In most of these countries commodity production is already above pre-war level, having sunk in 1944-5 to a small portion, despite the large reparation liabilities of some of them (e.g. Hungary) and the massive removal of capital equipment by the Russians as war booty. In contrast, in the western fringe countries, e.g. Italy or Austria, though in a *better* initial position and largely supported by U.S. aid, output is still well below pre-war.<sup>1</sup> Moreover, planned investment, especially investment in mining and manufactures, is on a far higher level in proportion to national income than in comparable areas in the West and steeply increasing with output. At the moment the concentration on heavy industry due to the political tension with the West has retarded the effect of this investment on national real income. Should the tension relax and these countries obtain equipment from the West or, if no war intervened, after these investment plans have been completed,

<sup>1</sup> E.C.E. 1949 *Report*, p. 21.

the standard of life in these countries will increase steeply, and for the first time in history the broad masses will be the main beneficiaries of this expansion. This might reduce opposition to the new regimes, and lead to a more liberal administration of security measures which constitute the most repulsive feature of these regimes to Western minds. In any case the material progress in these countries contrasts vividly with the stagnation, or even recession, especially in the poorest, most vulnerable countries, e.g. Italy and Austria—not to speak of Greece. If, as time passes, the contrast became even stronger—particularly if ‘sound’ policies are generalized and intensified—the attraction might come to outweigh those fears which have hitherto prevented the fall of democratic regimes by a victory of the Communists at the polls.

Repression of Communists might be practised for a long period over a large part of the world. But by itself it will not succeed in stamping out the idea. Moreover, its cost might prove so onerous that disillusionment on the part of those who must bear it—in the main the United States—might ensue with violent change in the personnel of the oppressors of the abandoned country. China might well be the first of a series of retreats. A final armed clash would then prove unavoidable, as successive *national* triumphs of Communism would inevitably evoke the feeling of its limitless international ambition and spreading. At a certain point—whatever the cause of fall of that particular area—an attempt would be made to end the intolerable strain by atomic action.

Conversely if we accept the challenge of Communism nationally and internationally on the plane from which it draws its strength, that is, the economic and social degradation of life for the majority in wide areas even of Europe, not to speak of the undeveloped continents, the argument for an intimate collaboration of the non-Communist communities, not merely on the social and economic, but also on the military field, is immensely fortified. Military strength will be a deterrent shield behind which the reasons for social discontent can be mitigated without revolution. It should prevent any military adventurism on the part of the Russian leaders—of which there is in any case little sign indeed so far.<sup>1</sup> The violent commotions in the East of Europe have only been possible

<sup>1</sup> It is unfortunate that the need to secure appropriations for the rearmament of Europe has led to exaggerated statements in this respect.



in areas where the penetration of the Red Army has assured the local Communists of absolute hegemony of armed force (and in Finland and Austria it was unsuccessful even by way of such limited intervention). In no case has the Red Army transgressed the frontier of a sovereign country since the conclusion of its drive against Nazi Germany. In Persia the U.S.S.R. evacuated strategically and economically highly important areas, in which she was, in all equity, entitled to secure limited rights of exploitation.

Thus the deterrent military preparation must be used wisely, and merely as a *deterrent*, not as a *menace*, if conflagration is to be avoided, and a tolerable equipoise is to be achieved. One cannot strongly enough deplore bellicose statements by political generals and militant politicians which suggest an impending crusade against the U.S.S.R. Coming from Europeans, they certainly represent a dangerous form of suicidal mania. However demobilized, the Red Army represents a weapon which can be brought to bear far quicker than any help from outside Europe. It is hardly conceivable that atomic bombing, however destructive it would be, could prevent military operations, at any rate, without the indiscriminate killing of friendly populations. Thus European defence, if a conflagration started, especially if it were not based on solid moral cohesion in the West, would hardly be successful. An armed conflict is therefore bound to be disastrous to European existence.<sup>1</sup> This does not mean that Russian pressure should not be resisted. But it means that firmness should not be confounded with threats.<sup>2</sup> The Soviet must be made to feel that the West equally dreads war as it also is determined to resist attack. At the same time measures must be taken to convince the leaders of the U.S.S.R. that they cannot hope for a disintegration of Western solidarity and stability as a result of

<sup>1</sup> Recent statements of high U.S. officers on the strategy of the Atlantic Powers assigning land fighting primarily to the French, and to a lesser extent to the British, are likely to undermine morale in Western Europe unnecessarily. It is hardly comprehensible how the lesson of the so-called phoney war period could be so quickly forgotten. The delivery of atom-bombs is no substitute for defence. The whole episode shows a tragic misjudgement of the problem of Western relations with the U.S.S.R.

<sup>2</sup> Nothing shows more clearly the difficulty with which military experts seem to adapt themselves to new situations than the suggestion that, in order to be able to possess power of retaliation independent of the consent of the U.S. Congress, Britain should attempt to manufacture atom-bombs. As an island, Britain's exposure to atomic attacks is of a different order of magnitude than that of continental empires, e.g. the U.S. and U.S.S.R. Even if her stock of bombs were a multiple of such an adversary, the basic geographical handicap prevents effective retaliation. To invite attack by attempting to manufacture bombs is therefore nothing short of folly. It is, above all, in Britain's interest to outlaw indiscriminate atomic butchery

economic disaster. Having demonstrated military and social strength, there is good hope for a peaceful settlement of differences on an equitable basis. The Russian leaders have always shown themselves realists, willing and able to change their policy at short notice.

It would be completely destructive to the conception of Western policy if Western Europe were to devote so much of its manpower to military preparations as to impinge on the essential task of social and economic recovery. Western European armaments cannot in any case achieve more than less extensive but more intelligently co-ordinated arrangements could equally attain, i.e. the moral certainty on the part of any aggressor of being exposed to unlimited retaliation by the unconquered territories of the alliance. It is to be hoped that the military and conspiratorial aspects of Communism, admittedly serious problems for any libertarian state, will be treated with more detached objectivity, and less as excuses for demands for American aid.

The growing importance of distinctly political, anti-Communist and anti-Russian aspects in Western European co-operation, and what is of greater consequence, in American help, might, in the longer run in any case, have unfavourable repercussions on progressive governments in Western Europe, even if they were the outcome of Soviet policies and mistakes.<sup>1</sup> The fact that the U.S. Congress, in distinction to the Administration, was largely influenced by the tension with Russia in voting aid to Europe, imparts an unfortunate factor of instability into the Western European system.

Western Europe, and especially Britain, must beware of giving the impression of being fearful of a settlement with Russia. American

<sup>1</sup> Already Continental, even German, Right Wing parties are offering themselves as more trustworthy allies to the United States. The folly of encouraging German nationalism as a counter to Communism which the Allies committed in 1919-21 with bitter consequences for the future is again rampant. The campaign against trial of people accused of mass murder and the dismantling of a small number of factories which are capable of producing military supplies is a symptom of how far the German position deteriorated. After three years of almost complete paralysis for which the Soviet were only so far responsible as they did not agree to a currency reform (but it is not certain whether the Western Allies had made any serious proposals to which the Soviet could reasonably have been expected to assent), continued deflation and unemployment combined with the fear of Russia have powerfully contributed to the renaissance of Nazi ideas on foreign affairs. Concessions to a nationalist Germany under blackmail would certainly have the opposite result from that expected by the strange new sponsors of Germany in Britain. Unfortunately the Western Allies even are not united in their policy towards Germany.

Isolationists on the Right and Left might otherwise be given a most damaging weapon against the continuation of aid *on its own merits*, for the reason that the two world wars have completely smashed the delicate balance of the world economic system.<sup>1</sup>

Another, hardly lesser, danger lies in putting forward proposals whose burden falls one-sidedly, and not justifiably, on American shoulders. Schemes which treat the U.S. as a milch-cow instead of putting forward simple moral principles applicable to all, must defeat themselves. The U.S. is by far the richest country in the world, and it has shown itself remarkably generous in granting aid to other less fortunate nations. But it would be intolerable if Europe, and especially Britain, were to try to escape its duty to much poorer areas. Only a scheme much wider than E.R.P. can now possibly appeal to the U.S. and escape the fatal charge of wishing to make her a 'sucker.'

In the following, concluding, section of this essay we shall argue that:

1. mass-emigration cannot solve the problem of the highly industrialized areas of Western Europe (unless a large portion of the population is eliminated) though it could contribute to that of the poorer areas. If mass-emigration is not followed by or used for a planned increase in agricultural and raw-material production the position of the former countries might be aggravated;

2. an international scheme to ensure the maintenance of high employment and expanding demand would necessitate the transformation of the International Monetary Fund into an International Central Bank with powers to create purchasing power accepted as lawful reserve by all Central Banks of the member countries. But even such a scheme would not solve the long-term dollar problem which is of a structural and not cyclical nature. Moreover, even the best of such schemes would create serious problems in underdeveloped areas. It would imply the creation of international credit whenever one of the major countries is threatened with unemploy-

<sup>1</sup> e.g. Senator Taft's speech against the Atlantic Pact. The growing fear in the U.S. of being dragged into a conflict with the U.S.S.R., however odd it may appear to a European, should be a warning that appeals to violent anti-Communism in the U.S. might have reached the point of decreasing returns. The constant pinpricks which seem to serve the British Foreign Office as a substitute for policy, neither increase British prestige nor do they have the intended effect in the U.S. The dignity of the country, in any case difficult to uphold in the rôle of a lesser ally, would be better preserved—even if no power-political intrigues were attempted—by keeping in the background, hoping to meditate rather than exacerbate Western relations with the Soviet Union.

ment and an increase in investment in under-developed countries. Credit creation—and investment—would have to cease, however, whenever prosperity in the depressed areas is restored, because otherwise inflation would ensue. Hence the under-developed areas—which are economically and politically the weakest—would periodically experience a sudden slump—inverse to the prosperity of the wealthiest areas;

3. a solution of the dollar crisis and of the problem of international inequality of opportunity could be found in expanding the International Bank for Reconstruction and Development into an International Investment Fund. This would represent a generalization of the conception of the Marshall Aid into an international scheme for development on the basis of the IVth point of President Truman's Inaugural Address, and the return to President Roosevelt's programme for the United Nations Relief and Rehabilitation Administration, which came to an untimely end because of the growing tension between East and West. With the end of E.R.P. several European countries should be in a position to participate in this approach to the solution of economic instability, which should by then have a well-tried technique.

The Fund would be alimented by contributions of the richest member countries. It would undertake investment projects on the basis of loans and grants. The former should aim at reorganizing wider regions to increase productivity. Interest payments and amortization should be applied—together with part of the contributions—to make free grants to the poorest areas to render them fit to participate in schemes of the first type. There should be closest co-operation between the Bank and the Fund, and anticyclical credits should be channelled through the Fund so as to minimize disturbance to the continuous development schemes.

The contributing countries should possess veto power over the use of their contributions and the use of cash created by the Bank. This power should be exercised publicly and accompanied by a reasoned statement. The political character of the reformed institutions should be frankly recognized.

4. The acceptance of this double scheme does not entirely eliminate the need to grant Western Europe temporary help through changes in commercial policy which represent an alternative to free grants. Unilateral tariff concessions and preferential

arrangements will be needed if the reorganization of the Western European structure and balancing of her payments is to be accomplished without undue worsening of her terms of trade.

5. Western Europe, and especially Britain, must reconsider the mechanism of planning for a better co-ordinated economic system, capable in the longer run of competing on equal terms and without external aid with the United States. The method of distributing Marshall Aid should be reconsidered and the objective needs of increasing European productivity more closely borne in mind. The resuscitation of controlled off-shore purchases might be one of the means of escaping the dilemma of having either to reward the improvident and inefficient or to enforce cumulative deflation.

Such reforms should enable the Western World to overcome the deflationary bias in the international market economy already prevalent in the 1930s, and considerably strengthened by the unbalance caused by the war.

#### THE MEANS OF WESTERN PROGRESS AND STABILITY

If these ultimate aims for the Western World find acceptance, the solution of the dollar crisis follows almost automatically. The shortage of dollars—which is merely an expression of the unbalance in the foreign payments of the rest of the world—is the result of dynamic causes, partly historical and accidental, such as the effects of two World Wars, partly technical and economic, which tend to widen the discrepancy between the productivity and the standard of life of the United States and of other, especially industrial, countries. This trend, combined with the American capacity for lending, tends to press upon less favourably situated manufacturing exporters. As the United States at the same time is also *grosso modo* an agricultural surplus country, the rest of the world—even the agricultural countries—are subjected to a deflationary tension. Moreover, as the sheer impossibility of receiving U.S. supplies without aid must lead, one way or another, to the elimination of U.S. exports, the danger of severe short-term deflationary bouts even in the U.S. arises, whenever the readjustments due to these long-term causes are attempted by the other countries.

Three intertwined and interacting problems arise which should be distinguished:

(a) There is, first of all, the periodic recurrence of the dollar

shortage due to the basic, structural unbalance, between the rates of dynamic growth, whenever the discrepancy in productivity has become too great to be managed by minor adjustments. This we may call the *structural* problem.

(b) Secondly, there is the problem of the increased instability of the world economy due partly to the vast productive power and the consequently very high investment capacity of the United States, and partly to her peculiar position in the world economy—unlike anything hitherto experienced. In consequence, foreign countries stand the risk of being subjected to strong sudden shocks as the U.S. purchases diminish and export pressure increases. This *cyclical* problem intensifies the first but should not be confounded with it.

(c) Finally, Western European recovery has not yet eliminated all the consequences due to the war. Even the period contemplated for Marshall Aid has not ended. Much has yet to be done. But, as we have seen, this special problem (unlike in 1947) plays a relatively minor rôle. European production has by and large regained, or even surpassed, its pre-war level.

The basic cause of the unbalance, the disproportionate wealth and income of the United States, however, rule out or, at least, should ethically rule out, solutions which do not bring about a better distribution in the material wealth of the world. Hence the orthodox approach to the problem must be repudiated. This, in fact, is what has already been accomplished by, despite the pseudo-learned propaganda against, the conception of the Marshall Aid, and what the orthodox school now so desperately attempts to reverse.

We shall first deal with the first two problems which will be with us for many years and then try to discuss the more immediate questions created by the recent changes in the economic background of the Western World.

## I. MIGRATION

There can be no doubt that the interruption of international migration virtually since 1914 has considerably contributed to the present discrepancy in living standards between the new and the old world. In the overseas countries, moreover, it has appreciably slowed down the rate of investment and thus aggravated the tendency to slumps. Both consequences must weigh heavily on Europe in its present debilitated condition.

The investment requirement for an immigrant of working age—if the capital intensity of the U.S. industry is to be maintained—is at least \$7,000 per head, but it might be as high as \$10,000. Moreover, if we take into account that equipment with modern machines, houses, etc., would be much costlier than the *average* value of equipment per head, it might even be higher. The immigration of 1 million workers from Europe would, therefore, necessitate \$7-15,000 million of investment, which would go some way in maintaining business activity in the U.S. At the same time Europe would receive the benefit of remittances which are drying up (recent immigrants would send home a larger part of their earnings than settled people). And the insistent demand for foreign food and raw materials in Europe would be eased at the same time. Here, then, we might see a complete and dynamic solution of our problems.

There are many factors which rule out this solution, and detract from its effectiveness even if it could be managed against fierce political opposition. The success of the scheme depends from the point of view of the recipient country on whether the immigrants will in fact be integrated into the economic system on the basis of the same amount of capital equipment as the average. If not—and in an individualist economic system there is no guarantee for it—the relative share of wages in national income will decline. This is the reason for the fierce opposition of Trade Unions to mass-immigration in an economy where full employment is not secure. Immigrants, moreover, are not merely consumers but also producers. Should investment activity increase as a result of their immigration, the dynamism of the U.S. would soon produce a yet greater increase in efficiency and sharper competition with Europe. A faster increase in the population would further stimulate saving in production costs in industries which are dependent on large-scale markets. In case of mass-immigration this might become an important factor. The rapid evolution of the U.S. into the mammoth she now has become, was, after all, to an appreciable extent the result of migration.

There are countries in Europe, especially Eastern and Southern Europe, which are so overpopulated that emigration would not reduce their total production. Hence any emigration would increase world production and ease the global European problem. Britain, however, could only hope for a consequential improvement in her

position, if the addition to population overseas would increase primary rather than manufacturing production. Otherwise the increased consumption of immigrants from most European countries—as compared with their consumption at home—will reduce primary supplies available to Europe by more than Europe saves in imports as the result of their emigration. There is little reason to believe that the emigrant would tend to enter primary production unless deliberate action is taken. Thus the terms of trade of the European manufacturing nations might be menaced rather than relieved by a movement of population. Wide open spaces suitable for settlement without considerable previous investment and planning no longer exist. The repetition of the tremendous increase of primary production in the nineteenth century cannot be looked for so much by settling new areas as by intensified production. This, indeed, is one of the main avenues which need be explored. But it does not demand as much migration.<sup>1</sup>

It seems, therefore, that mass-emigration could hardly ease the overall European problem considerably. It would probably make the position of Britain more difficult; but it would contribute to the solution of the problem of poorer Western European nations. Scepticism about its economic consequences to Britain, however, should not encourage opposition to a liberalization of migration. The welfare of the emigrants would undoubtedly increase and there are other, non-economic (e.g. military), reasons for the support of such a policy. But emigration can only contribute to the solution of the troubles of the more industrialized countries of Western Europe if the dynamic character of the European problem is firmly kept in mind and if it is carefully planned in connection with other schemes.

## 2. INTERNATIONAL BALANCE AND FULL EMPLOYMENT

Schemes to mitigate international economic fluctuations are based on the consideration that, if full employment were maintained by supra-national arrangement in the world economy as a whole, steps could more easily and securely be taken by debtor countries to readjust their unfavourable balance of payments without having recourse to discriminating measures. These debtors could no longer plead that their import surplus was not due to their misguided (or over-enthusiastic) policy, but to deflation elsewhere,

<sup>1</sup> Some migration might be required to provide public utility and other services



which pressed unduly on their exports, and tended to increase their imports. Nor could they excuse their failure by arguing that a deflationary policy would start a world-wide downward spiral. The classical see-saw movement of international readjustment—the surplus countries expanding, the deficit countries contracting, with the system as a whole remaining in overall equilibrium—would at last be implemented in practice.<sup>1</sup>

The Bretton Woods scheme was a misconceived attempt to achieve this aim. It failed because its authors under-rated the magnitude and misjudged the nature of the problem they intended to solve. Its rigidity and the insufficiency of the means were the two main reasons for the failure.

In an essay written in 1943, the conclusions of which do not seem to require any modification, the following methods of international stabilization were distinguished:<sup>2</sup>

‘Theoretically the problem of maintaining full employment in any single country, or a group of countries, can be solved in two ways by international agreement:

(a) Schemes can be elaborated which enable single countries to maintain full employment irrespective of the consequences of this policy on their balance of payments, by creating internationally acceptable means of payment, and restoring the liquidity of member countries. We might call this the liquidity approach.

(b) Alternatively schemes could be elaborated which maintain the external balance of full-employment countries by offsetting the induced<sup>3</sup> surplus of under-employed countries, either by creating additional demand and diverting it away from the surplus countries, or

(c) by imposing obligations on the depressed surplus countries to eliminate the induced surplus.

In the following we shall attempt to discuss the most important of the proposals put forward in recent years. Institutionally they can be divided into those which hope to maintain demand by international action, i.e. by creating an international Central Bank, and

<sup>1</sup> Cf Chapter 3, on the complication of the problem of readjustment by business cycles, also my essay, ‘The international aspects of full employment,’ in the *Economics of Full Employment*, Oxford, 1944.

<sup>2</sup> *op cit*, pp. 158–9

<sup>3</sup> i.e. induced by the deflation in the surplus country.

those which wish to achieve stability by co-ordinating national measures.<sup>1</sup>

(a) The *modus operandi* of an international Central Bank is identical with that of a national Central Bank financing an anti-cyclical Government deficit. Whenever a slump starts and, as a result, the balance of payments of the countries suffering from the depression show increasing surpluses which threaten to absorb the reserves of other countries, and force deflation on them in the defence of the remaining gold or other liquid holdings, the International Central Bank intervenes. It creates purchasing power<sup>2</sup> by rediscounting the debt certificates of member governments and of creating international currency which is accepted by all member countries as reserve, i.e. cash equivalent to gold, against which national currency must be issued by the national Central Bank. The difference between those schemes which rely on the creation of cash alone and those which attempt to direct demand in a preconceived fashion is in that the first type of plan provides for the grant of credit to the debtor countries without regard to their wealth or stage in economic development, while the second reserves the credit to countries which are in need of economic development and take steps that the credit granted should be used to make purchases in

<sup>1</sup> Combinations between the two types are, of course, possible. Lord Keynes' original Clearing Union hoped to reduce the volume of balances which had to be dealt with by his Central Clearing Office through co-ordinated national action. Cf. below.

<sup>2</sup> In the essay quoted the scheme is analysed in the following terms (p. 159): 'Schemes of this type—i.e. which permit single countries to maintain full employment, irrespective of the consequences of this policy on the balance of their international payments, by creating and placing at their disposal internationally acceptable means of payment—represent the introduction into the international plane of modern Central Banking. They do not create or direct demand so as to maintain or help to maintain full employment where it is threatened by shortsighted policy. They enable a country which wishes to maintain its international demand (i.e. deficit) to do so by putting at its disposal the necessary means.'

'The late Lord Keynes' high hopes for his multilateral clearing scheme (cf. House of Lords, May 12, 1943, column 531) seem to be based on a similar misapprehension for which he took Professor Cassel severely to task (*Treatise on Money*, Vol. I, pp. 188-9). This misapprehension amounts to equating the volume of money with demand. Lord Keynes in the relevant passage of his speech explains that the principle of multilateral clearing means a generalization of domestic banking to the international field, *thus converting hoarding into lending and preventing deflation*. But the failure of the clients of the banking system to use their deposits, i.e. the fall in their effective demand, does not increase the cash reserves of the banking system; hoarding of bank deposits can only be "offset" if there exists an outside body, i.e. the central bank, which creates new cash and either induces entrepreneurs to increase their outlay, or if the Government increases its outlay. Correspondingly on the international plane there must exist an 'outside' (supra-national) body which creates new international cash, whenever international effective demand flags, and this body must induce a country or a group of countries to use this newly-created cash and thus convert it into effective demand. The automatism postulated by Lord Keynes is non-existent. It could be created only by a special scheme.'

those deficit countries which are rich and industrialized. The deficit countries are thus enabled to balance their payments without having to restrict their imports from the—depressed—surplus countries, and the depressed countries are helped in so far as their surplus helps in maintaining their domestic employment. In all these cases the multilateral character of international trade is maintained.

By creating a truly international Central Bank with discretionary powers to create cash—with certain safeguards for the creditor countries—the expansionist bias of the world economy of the nineteenth century would once more be recreated. It would be able to absorb the international 'hoarding' which finds its expression in deficit and surplus balances. These balances arise because unemployment cuts the imports and encourages the exports of the depressed countries. It is essential, therefore, for the successful working of the scheme that

(i) on the one hand there should be no *a priori* limit to powers to create currency, and

(ii) on the other hand credit should only be created in the measure to ensure full employment and no more, i.e. any tendency on the part of the debtor countries to continue their policy which creates import surplus after full employment has been restored must be firmly checked unless it is the result of long-term loans or development schemes.<sup>1</sup>

The failure of the Bretton Woods Fund can be traced to the neglect of the first of these conditions.<sup>2</sup> A fixed fund was created

<sup>1</sup> This is yet another aspect of the recurrent dilemma of how to stimulate readjustment while preventing actual deflation.

<sup>2</sup> Cf. Appendix and *The International Aspects of Full Employment*, op. cit., p. 162. 'If this type of scheme is adopted it can be successful only if the amount of reserves available to member countries in case of need is in all circumstances large enough to permit the continuation of the full employment policy by all countries who so desire, during any depression that is likely to develop in the countries not adhering to a full employment policy (The internal stability of the system—e.g. the flexibility of wage rates, political conditions, etc.—will be the decisive factor in this respect) The size of the reserve is the determining factor, as such schemes do not provide a mechanism for the continuous redistribution of the reserves, if disequilibria sterilize them in any one country. They are not "public works" schemes but "central banking" schemes. The required volume of liquid reserves will depend:

(a) on the importance of the potential areas of depression in the world economic system;  
 (b) on the possible maximum severity of their depression;  
 (c) on the effects of the depression (and their economic policies followed in a depression) on their balance of payments.

The larger the share of the area of potential depression in the money income of the world at current prices and exchange rates, the greater their potential instability, and the stronger their bias to develop export surpluses, the wider must be the limits for the creation of additional reserves. The size of the total means required for the successful working of a scheme

instead of a Central Bank. Moreover, political considerations limited the volume of the Fund while little attention was paid to the probable magnitude of international balances which would be likely to emerge from the unbalance created by the war in a possible U.S. depression. Its action can best be illustrated by the reference to the so-called National Banking System in the U.S. prior to the establishment of the Federal Reserve System. The National Banks also represented an 'additional' (i.e. additional to the gold supply) source of cash. They could not prevent appalling financial crises, however, because their powers of creating cash were fixed by the volume of certain outstanding types of U.S. Government obligations. Whenever cash requirements in the U.S. rose above a certain level, a purely financial crash could always be predicted. Similarly the total of the Fund at the end of April 1949 was \$8,000 million, of which only \$2,800 million were gold or dollars. In a period of unparalleled stress it 'sold,' i.e. lent, foreign currencies only to the extent of \$725 million, i.e. a tiny portion of the U.S. aid extended in the same period and judged necessary by competent observers and even the Appropriations Committees of the two Houses of the U.S. Congress. As help to members is, as a general rule, limited to 25 per cent of their quotas and the non-North American quotas are just five-eighths of the total of the Fund, the help in any one year is limited to roughly \$1,250 million. Even in the short depression of 1937 the fall in the supply of dollars to the rest of the world was greater; it now seems probable that the decrease between 1948 and 1949 in the amount of dollars available will also be higher (nor must it be forgotten that the first impact of a depression hits the rest of the world unequally, and that therefore deflation might be imposed on certain members

of this type is therefore a function of the future home employment, of the commercial and of the international lending policy of the countries which are parties of the agreement. A currency agreement of this character cannot safely be negotiated in isolation, irrespective of agreement or otherwise on policies which affect the size of the possible balances with which the scheme is to be called upon to deal.

'The working of the scheme will, it must be remembered, mitigate the depression in the unstable area as the export surpluses, which it permits, have the same effect as home investment. It will, therefore, depend on the quantitative relationship between foreign trade, (this, again, will depend on the relevant income and price elasticities of demand and supply in the depressed area and the full employment countries respectively, and the initial position of the balance Cf Mrs Robinson, *Essays*, pp. 193-5 and above) and that level of home investment which is necessary to obtain full employment in the potentially depressed area, whether an export surplus due to depression is likely to reverse or merely to mitigate the fall in effective demand in the unstable area. But even if export surpluses are insufficient to restart expansion, they will speed recovery.'

before others have exhausted their annual drawing rights). The authors of the Fund realized this weakness of their scheme and tried to overcome it by permitting member countries to discriminate against, and so diminish the demand for, the exports of such surplus countries, the currency of which had become exhausted in the Fund.<sup>1</sup>

Unfortunately the size of the U.S. contribution and the stringent safeguards against too rapid a use of the facilities offered by the Fund render this clause ineffective in safeguarding the world against a dollar shortage. Most countries might already be exceedingly short of dollars without the Fund having parted with its holdings. In any case the invoking of the scarce currency clause would in itself represent a breakdown of the original purpose of the Fund, the safeguarding of full employment without monetary discrimination.

The establishment of an international Central Bank would certainly overcome this fatal weakness of the International Monetary Fund in its present form. But it would have two serious shortcomings. The first, and main, is that it would result in the haphazard accumulation of debt by countries which are objectively in no need of foreign borrowing<sup>2</sup> and such debt might not be easily reduced because, even at full employment, the erstwhile creditor might not be willing to receive import surpluses. Secondly, it might encourage reckless policies by debtor countries which could not be easily reversed after full employment has been restored in the country whose depression had been the proximate cause for creating additional international reserves. This consideration led to the

<sup>1</sup> The so-called scarce currency clause, cf. Appendix.

<sup>2</sup> Cf. *op. cit.*, p. 161 "To allow depressed countries to run up export surpluses which would permit the maintenance of full employment policies everywhere, has the drawback that the cumulative debit balances would be distributed haphazardly. Unless they are periodically waived they would tend to force mature deficit countries to adopt deflationary policies, as such countries will not in the long run tolerate a growing indebtedness, however vague the obligation to "repay" these "cyclical liquidity" debts.

Steps against deliberate attempts by single countries to indulge in inflating effective demand beyond their productive power, without voluntary agreement to obtain foreign loans, must be taken as soon as the whole system is in itself fully employed, for the continuation of true inflation in any one country then would tend to result in inflation of the whole system. As long as a large number of member countries are unemployed, however, the expansionist policy of a member country will merely help to re-employ idle capacity in the depressed countries. It would, therefore, not force them to forgo any productive opportunity. (Foreign investment leads to "inflation" in the borrowing country, but this "inflation," if the foreign loan was well conceived, is matched by an increased productive capacity.) In the absence of full employment policies, the countries with excess capacity have little reason to complain of an expansionist, or even "inflationary," policy in other countries.'

elaboration—much before the Bretton Woods Conference—of plans which try to deal with the problem by direct action.<sup>1</sup>

The most logical and effective scheme—elaborated by Messrs. Schumacher and Kalecki<sup>2</sup>—creates not only *liquidity* but *demand*. It creates it in that area of the world where it is most needed—in the immature countries—by granting them loans and placing at their disposal liquid funds created for the purpose by an International Investment Board. This demand is canalized towards those countries which have a deficiency in their balance of payments which they wish to readjust because, being 'mature' countries, they must not rely on foreign loans for capital development.

In this way, additional world demand is created which permits the balance of payments of fully employed mature deficit countries to be restored to equilibrium. Without this help these countries would have to cut their purchases abroad, thus causing a depression elsewhere. This solution is far more complete than the 'liquidity' approach in so far as the cumulative 'induced' deficits due to the depression of a large 'mature' country would be canalized to under-developed countries. These countries would use the supplies so obtained to increase their productive capacity. The mechanism of long-term lending would be restored in an improved form. Deficits in the balance of payment of fully employed countries induced by the 'depression' in other countries not maintaining full employment, would be wiped out if they were not needed for accelerating capital equipment. Full employment would be maintained by diverting products towards those countries most needing them: products which, without this intervention, would not have been produced.<sup>3</sup>

(b) The political difficulties involved in creating an *international* Central Bank with powers to create cash have led to a search of alternative methods which try to achieve balance by acting through *national* policies.

<sup>1</sup> *ibid*, p. 159

<sup>2</sup> *New Plans for International Trade*, op. cit

<sup>3</sup> The International Board will therefore only utilize or develop resources which would otherwise not be utilized. It should be noted that, in view of the vast discrepancy in the standard of life between different countries, especially after the war, this method is not a sufficient answer to the problem of international investment. International lending beyond these limits, however, would necessitate restriction in the immediate consumption of the rich countries and must therefore be undertaken (with or without the intermediary of an International Investment Board) by a conscious policy of collaboration of the rich and poor countries. Cf. below.

The simplest and most 'orthodox' of these is a periodic revaluation of gold in terms of the currency of the greatest surplus country.<sup>1</sup> In this way the surplus country would not only increase the value of the annual gold production until it reaches the level of its surplus, but it would also make large paper-profits on its existing gold reserve and thus be able to pursue an expansionist budget policy without 'unbalancing the budget.'

It would be a silly and wasteful way of solving the problem of the dollar shortage, but far preferable to the artificial encouragement of competitive deflation. If, for example, at present the U.S. were to increase the price of gold from \$35 to say \$100 an ounce fine, the supply of dollars from newly-mined gold would probably increase to some \$1,500 million or more (as gold production would rise). The U.S. Treasury would, moreover, make a profit on its existing holdings of gold of some \$50,000 million. Thus a large programme of public works could be started without budget deficit and an increase in the national debt—of which so many are so terrified in the U.S. Politically, the fact that it is by no means certain that a rise in the price of gold would benefit Western countries only, represents an additional handicap for its acceptance by the U.S.

An alternative approach—which seems to have been envisaged by Lord Keynes in the original form of his International Clearing<sup>2</sup> scheme—would be to insulate the world economic system compulsorily from the consequences of a slump in any one country by forcing that country to undertake readjustments. This approach would demand that the surplus country should automatically appreciate its currency, and/or that it should increase its imports for any given level of national income by way of reducing tariffs and other impediments against imports, or increase the level of its money wages and thus act both on its exports and imports.<sup>3</sup> Alternatively, it might be suggested that foreign claims, if these have come about as a result of the internal deflation in the creditor country and not

<sup>1</sup> Cf *ibid*, p. 162

<sup>2</sup> And subsequently revived by the London meeting of the Preparatory Committee of the U.N.O. Conference on Trade and Employment Cf 'The Charter of I.T.O', Institute of Statistics *Bulletin*, op. cit., 1947.

<sup>3</sup> These suggestions were dropped at an early stage of the Anglo-U.S. conversations. Under certain conditions an increase in money wages would aggravate the problem, i.e. if foreign demand for the exports of the surplus country is intense and if the increase in incomes is not spent to any appreciable extent on imports

the conscious granting of long-term loans, should be periodically wiped out.<sup>1</sup>

Either alternative could, in fact, work. They could largely neutralize the effects of a slump in one country on the world, or would at least reduce or wipe out the surplus resulting from the reduction of effective home demand on the balance of payments.<sup>2</sup> But the first alternative would automatically aggravate the depression in the surplus countries, as it would eliminate the improvement in the balance of payments, which had arisen as a result of the slump and which tended to offset the fall in the effective demand in that country. If the depressed country does not increase home demand, by deficit spending or otherwise, the vicious deflationary spiral might continue and thus necessitate further doses of the same external readjustment, each of which would give further impetus to internal deflation. The second method of forgiving surpluses would be opposed not merely because it could be claimed—unjustifiably<sup>3</sup>—that goods would be ‘given away,’ but also because it increases the internal national debt of the surplus country.<sup>4</sup>

Finally one might generalize a proposal made by the U.S. State Department<sup>5</sup> for the regulation by the International Trade Organization of relations with members having a complete State monopoly of foreign trade to achieve much the same aim. These countries would have had to pledge themselves to take at least a certain guaranteed minimum quantum of imports over an agreed period. If this were to be applied to all countries—at least in respect to food and raw material imports—a long step would have been taken to apply internationally the methods of domestic price stabilization for

<sup>1</sup> Cf. H. Feis, *Foreign Affairs*, 1942.

<sup>2</sup> If its claims on other countries, fixed in terms of its own currency—e.g. interest—represent a large fraction of the total balance of payments, then an appreciation of the currency may aggravate the problem rather than help it, if the countervailing measures increasing the foreign trade multiplier do not more than offset this effect.

<sup>3</sup> Unjustifiably if the alternative to the export surplus is unemployment. Indeed, in so far as the export-surplus will, because of its multiplier effect, increase home demand, its social cost would be negative.

<sup>4</sup> The British Scheme tried to meet this last objection by limiting the size of additional liquidity quotas to be granted to would-be debtors. If quotas are limited to such an extent as to appease the would-be surplus countries, the danger arises that their volume will be fixed so low as to lead to their exhaustion at the first severe depression. (This is, in fact, what happened. The safeguards must be so constructed as not to paralyse the equilibrating mechanism.)

<sup>5</sup> *Suggested Charter for an International Trade Organization of the United Nations*, Department of State, September 1946, p. 22, para. 28.



primary products now accepted and practised by the United States. Thus one of the most potent causes of instability would be eliminated. It would, however, be politically probably more difficult to secure acceptance of this proposal than for an expansion of the International Monetary Fund to a full Central Bank. It would also be less easy to manage and adapt to changing circumstances.

We have surveyed the various proposals made in the last few years to limit, if not eliminate, the spread of international depressions. Those acting through national policies have the grave drawback of being uncertain in timing, especially because they are bound to provoke serious sectional opposition in the creditor countries. This opposition will partly be stimulated by ideological-mythical reasons, (e.g. the opposition against a revaluation of gold in so far as it does not arise out of the fear of strengthening Russia) or it might originate in the threat to existing vested interests implied in such proposals (e.g. the proposal that creditor countries should deliberately try to worsen their balance of payments). In any case it is sufficiently serious as to lead one to discount this type of solution.

Among the plans involving the creation of an international Central Bank, the Schumacher-Kalecki scheme, which combines the establishment of such an institution with a limited degree of planning the economic development of backward areas, would offer not only substantial economic but also political advantages over all other proposals. As a method mainly aimed at offsetting cyclical fluctuations, even this plan, however, suffers from one overwhelming disadvantage. The international Central Bank's powers to create credit is restricted to periods in which the (richer) countries suffer from unemployment. Once its measures promoting balance of payments deficits have restarted expansion in the depressed countries through credits or investments to under-developed countries, the policy has to be reversed. Thus there will be a tendency to inverse cyclical fluctuation in the weaker and under-developed countries which are least able to stand them. Measures to smooth or mitigate cyclical fluctuations do not avoid periodic large-scale shifts in the direction and pattern of trade and employment. This is the exact international equivalent of the domestic difficulty involved in the 'liberal' Keynesian countercyclical domestic public works or similar

spending schemes,<sup>1</sup> which necessitate a periodic change of occupation among workers. Hence they do not provide a complete solution either of the full employment problem or of the problem of facilitating readjustment.

It would be far preferable to achieve international full employment and a better international distribution of wealth by a *sufficiently large international investment scheme* which would energize even the richest country, with the largest savings rate, to sustained activity. It might be emphasized, however, that so long as each important member country does not provide for its own internal stability, any permanent international settlement should also envisage the creation of an international central banking and investment institution. The organization created at Bretton Woods would provide an admirable nucleus for the purpose. We shall deal presently with the required modification of their charters.

### 3. A BOARD FOR INTERNATIONAL ECONOMIC DEVELOPMENT

The malaise of Western Europe, the erstwhile workshop of the world, is due not to cyclical but to structural causes, though a world depression would aggravate its ills. A satisfactory solution of its problems can only be envisaged by bringing into being a better co-ordinated, more specialized, hence more efficient, European economic system capable of matching U.S. competition on equal terms in third markets. Moreover, measures will have to be taken to provide these markets for manufactures.<sup>2</sup>

All evidence points to the conclusion that spontaneous growth on the basis of private domestic saving and international private investment will not provide, under modern conditions, sufficient markets for European manufactures while facing the full blast of U.S. competition. World production of manufactures doubled between 1913 and 1937. The volume of international trade in them, however, remained unchanged. Despite an almost equally stringent regulation, international trade in primary products increased considerably

<sup>1</sup> Such as, for example, elaborated by the White Paper on 'Employment Policy of the Coalition Government'. The increase of the depressed countries' demand for the exports of the under-developed countries as the result of their recovery is hardly likely to offset this effect.

<sup>2</sup> This is increasingly realized by enlightened U.S. observers, e.g. Mr W. Lippmann in the *New York Herald Tribune*, July 16, 1949.

in the same period, even if not quite as much as their production, i.e. by 25 as contrasted with 45 per cent.<sup>1</sup>

The war has increased the self-sufficiency of most overseas countries. If measures are not taken to sustain and increase demand for manufactures, a cut-throat competition between manufacturing nations for markets would probably induce deflation among them; the primary producers will, in all probability, not gain either. The demand for their products does not vary much with price. If incomes fall they may well find themselves in the same position as in the 1930s. It is a mistake to suppose that the discomfiture of suppliers who are also customers benefits their trading partner. A cumulative deflation ruins all, and benefits no one. Moreover, in the competition in third countries with U.S., Europe would have to try to gain ascendancy over the U.S. in precisely those fields in which the U.S., as we have seen,<sup>2</sup> has special advantages in production but in which the U.S. would be successful even at identical costs and prices: in standard capital, and durable mass-manufactured consumer goods, taste and prestige—not to mention lending capacity—now favours the U.S. Nor should it be forgotten that an enforced balancing of exports and imports between Europe and the U.S. would divert U.S. manufacturing capacity now engaged in supplying Europe to third markets. The clash would be a formidable one. Europe would be already at a disadvantage in that she would have to forgo using modern U.S. equipment not available elsewhere. Nor must it be forgotten that the present high level of British exports is not due to an increase in the volume of world trade, nor yet of the transformation of the U.S. into a 'high-living and high-spending' community and one which spends *abroad*, but to the decline in the German and Japanese share. The policy pursued by the U.S. at present, which implicitly tries to reduce U.S. exports to Europe, which stimulates revival in the production and exports of the former enemy countries, yet does not take steps to expand overseas demand for manufactures, must end in extreme monetary unbalance.

Nor must the consequent difficulties of the U.S. be underestimated. Not only would a number of her industries be appreciably harmed, but she would have to reduce the calorific content of her final agricultural output considerably and divert industrial production. Her exports would have to be reduced by some 40 per

<sup>1</sup> League of Nations, *Industrialization and Foreign Trade*, 1945, p. 157.

<sup>2</sup> Chapter 1.

cent or even more if service and repayments on investments and loans are to begin without further capital export in bulk.<sup>1</sup> A loss of income of \$4-5,000 million p.a. would not be serious in an economy with a national income of over \$200,000 million. But some of the loss will be cumulative as it might undermine the stability of U.S. internal markets and intensify the need for Government support. There is no indication in the various agricultural price-support schemes now under violent discussion that this problem has even been faced, far less solved. Such transition could no doubt be accomplished. Her construction industries would have to be greatly expanded. This is shown by the fact that even in 1948, when a relatively small part of her resources were devoted to domestic construction (as contrasted with equipment and exports), serious bottlenecks appeared. Full (or even a high level of) employment in the U.S. without appreciable foreign lending would demand housing, social amenities and public utility schemes of colossal magnitude. Her agricultural production would have to be deliberately reduced and diverted into high-value commodities, such as meat, dairy products, etc., which use much more land for a given calorific value. Conversely, steps would have to be taken to increase domestic mass-purchasing power to find markets for a greatly increased supply of these products. Unless the transfer of resources is planned and managed carefully, a sharp and prolonged deflation is only too likely.

However desirable these measures might be from a purely American point of view, they can hardly be introduced quickly. And even if they could be, it might be questionable whether the richest country should deliberately enforce such a total readjustment at this juncture. It would result in a nutritionally less efficient use of land, a shift of man-power from industries with high (heavy and mechanical industries), towards those with relatively lower efficiency (consumer goods and construction). Moreover, this policy would probably result in a general crisis at home and certainly abroad, as the path of readjustment will not be smooth. The U.S. could well afford an exceedingly high rate of social advance and domestic investment even if she contributed with unique generosity to the development of less fortunate countries, and thus would be able to

<sup>1</sup> Cf Chapter 4 on the possible rôle of private investment, and on the possibility of dumping agricultural produce, and its consequences to Europe

escape the need for such large-scale internal economic readaptation. The American economic system is one of which it might be said: to him who gives, shall be given.

There is a further point. Western Europe has no doubt suffered a damaging blow against the very basis of her existence. But in comparison with Africa and Asia her standard of life is still immensely superior. A scheme which tries to syphon aid from the U.S. exclusively, or even mainly, for helping Europe has a weak moral basis and would probably be short-lived. It is dangerous to base a long-term programme on political or military expediency. Only a general plan in which all countries with a high standard of life participated according to their ability, could possibly evoke the will to sacrifice which is required if the Western World is to rise to its responsibility.

The basis of such a programme was given in the Fourth Point of Mr. Truman's inaugural address. The President demanded action to speed up the economic development of backward areas by making available to them the great technical facilities at the disposal of the United States. It is regrettable that the British Government did not respond immediately to this suggestion and offer to participate in it. The quick reaction to General Marshall's Harvard speech much contributed to the successful launching of the European Recovery Programme. And the Fourth Point contained the seed of an even further-reaching new departure in constructive economic policy.

A long-term programme to deal with the miserable poverty of the greater part of the world can, of course, not be restricted to sharing of what the Americans term 'know-how.' In order to make the under-developed areas capable of utilizing the superior technical knowledge of the West in a measurable time, immense capital investment would be needed. Schools, health, and public utility services are in most cases a condition to quickened progress. Effective action to carry out President Truman's suggestion would seem to entail a broadening of the scope and a change in the methods of operation of the International Bank for Reconstruction and Development to which the Bretton Woods Final Act assigned the duty of assisting in the promotion of greater international equality in the distribution of capital. A full programme of development would demand the reorganization of the Bank into an International Investment Board to which a rising proportion of the national

income of those countries would be assigned whose output per head has increased beyond a certain level. The Board would have the duty to expend these grants in the poorer areas of the world. The investment programmes must not be selected necessarily or narrowly on an economic basis. They should consist of a judicious mixture of two general aims: on the one hand they should attempt a planned increase of productivity in large regions by stimulating rationalization and co-ordination of economic plans. On the other hand the establishment of minimum standards of health, education, communications and public utilities, primarily irrigation and connected electrification schemes should be envisaged to prepare the poorest countries for an eventual participation in plans of the first type. Need and economic progress should be the twin criteria to be laid down. In most of these cases direct yields which private investors would obtain are either negligible or subject to very great risks.<sup>1</sup> Without an International Board such investment would therefore either not be undertaken or the loans contracted for it would be subsequently defaulted upon, with catastrophic results on the regularity of the flow of investment, and thus on international stability. Moreover, as the possibility of repayment would largely be determined by the policy of the creditor nation—i.e. to an overwhelming extent the United States—and as the willingness to receive repayment is very questionable, the outcome of an attempt to rely on private investment is to court certain failure.<sup>2</sup>

<sup>1</sup> Cf. my article on 'Problems of post-war international investment policy,' *Oxford Economic Papers*, No 7, 1945. It is interesting to recall that this paper was subjected to severe criticism by adherents of *laissez-faire* because it was sceptical about the scope or desirability of private international investment and about the newly-founded International Bank in ensuring international stability or increasing the speed of development of poorer areas. It therefore proposed the establishment of an International Investment Board. The hostile reaction to this proposal in Britain is typical of the failure to realize the magnitude of the change in Britain's international economic position and therefore in her true interests.

<sup>2</sup> The total insufficiency of the means at the disposal of the International Bank is only matched by their immobilization due to its charter which lays down that only 'economically' (i.e. financially) sound single projects should be financed. Even after a broadminded re-interpretation of this clause the Bank did not succeed in its first three years of existence to grant \$500 million of loans. Its loan charges were relatively high (3½ per cent, plus commission, bringing the charge above 4 per cent) for the aim of large-scale development. The maximum effective (i.e. dollar) loan capacity is less than \$4,000 million, which—if the average currency of loans is 12½ years (i.e. if they are redeemable in twenty-five years) limits the eventual annual lending power to some \$300 million—if no defaults occur. Yet the late President of the Bank ('The Lesson of the World Bank,' *Foreign Affairs*, 1949, p. 557) stated that the means of the institution were ample and that it experienced difficulty in finding 'sound' projects. The inauguration of the Marshall Plan no doubt limited its field of activity in Europe. It could hardly be said, however, that there were no other urgently-needed

The development credits granted should carry a modest rate of interest and eventually be amortized if compatible with stability, preferably paid in services and commodities, used together with current grants for the promotion of further 'non-economic' schemes. The grants should be free from such obligation, but their counter-value in the home currency of the recipient should be subject to the same control as now exercised by the U.S. Administrator over the counter-value of Marshall Aid supplies. Certain minimum conditions might be laid down in respect of social and economic policy for eligibility for such grants.<sup>1</sup> This is particularly important in backward areas where governments often find themselves unable to carry through essential reforms because of local political pressure and irrational prejudice.

There is no reason whatever why Britain, along with other of the more fortunate countries of Western Europe, should not participate in such a scheme. Its commitments to colonial welfare schemes and, possibly, that part of the liquidation of frozen sterling balances which is the result of the wartime economic policy in the Middle East, might be included in its contribution. It has been shown last year that Britain can stand on its feet without any *net* aid, provided an artificially restrictive policy is not pursued the world over under the slogan of 'disinflation.' There is no reason why she should not increasingly contribute to the development of the poorer areas, the hopeless misery of which is a standing accusation against the profession of high ideals by the West.

Should it be decided—to give an example<sup>2</sup>—that countries should participate whose national commodity output per head exceeds \$150 per head per annum, Sweden, Switzerland, the U.K., Den-

development problems to be tackled elsewhere. It is the conception of the rôle and methods of an international institution for economic development which requires reform. Incidentally it is interesting to observe that over 75 per cent of the loans granted were spent in the U.S.

<sup>1</sup> The need for such conditions is suggested by the anomalies which have become apparent in the administration of Marshall Aid. As a result of favouring *laissez-faire* solutions, individual American taxpayers even in relatively modest conditions contribute to the maintenance in many countries of ruling classes of questionable character in a state of luxury (often directly, the import of luxury cars in bulk) of the very existence of which few Americans can possess a notion except perhaps from cinema performances. In the northern countries the U.S. contributor can at least be certain that his sacrifice will be used to maintain minimum standards of those most in need. But such is the logic of many that more complaints have been voiced in the U.S. against health services, food subsidies, etc., than against conspicuous waste financed by foreign aid. Indeed, some obviously are eager for Britain to follow the Continent in purchasing Cadillacs rather than infants' food out of the Aid.

<sup>2</sup> On the basis of E.C.E. Report, op cit p 21, in terms of \$ of 1938 purchasing power.

mark, would be called upon to make contributions. As income increases the percentage contribution should rise. Funds rising to at least \$3-4,000 million per annum should be made available as Marshall Aid declines. The automatic expansion of the scheme through the increase in world real income would carry it at a steady rate towards much higher figures. At a later date it might be modified in the light of circumstances and experience. Suitable formulae are not difficult to elaborate. They should take into account the fact that as income increases, savings increase more than in proportion.<sup>1</sup> Hence economic stability would seem to demand steadily increasing investment outlets which will not necessarily be automatically available. Thus contributions on progressively increasing scale would be needed. The establishment of an Investment Board on this basis would by itself reduce the probability and amplitude of economic fluctuations, though, as the present recession in the U.S. shows, it would not eliminate them. It would have to be coupled therefore with the international stabilization scheme discussed in the last section. As it expanded it would provide the basis of a true international full employment policy without creating inverse cyclical fluctuations in the poor areas. It might be objected that if booms develop in the contributing rich countries in consequence of the inauguration of the scheme, fluctuations might still occur. This is true. But it is less difficult to curb booms than stop slumps, and the scheme itself would provide an element of buoyancy which was the saving characteristic of the nineteenth century and the absence of which after 1929 was responsible for much of our troubles. The expansion of the scheme should be gradual because its success would seem to require a vastly increased supply of technical and managerial staff of high competence, and this takes time.

An international body with powers to grant or to withhold aid for economic reorganization and development must necessarily be political in character. The insufficiency of means and thus the exceedingly limited usefulness of the two Bretton Woods institutions is, perhaps, directly traceable to the refusal of its authors to face the fact that they were grappling with political problems which cannot be disguised as purely technical economic questions

<sup>1</sup> The rate of saving tends to fall in time—provided that fluctuations and growing risk do not enforce caution. Unfortunately the initial increase of savings might well evoke the fluctuations in activity which prevent the decrease of savings needed to ensure stability without planned intervention and management Cf Chapter 4.



and handled on the basis of set criteria. Nor did they face the fact that no government and legislature, and, especially not the U.S. Congress, would at this moment give an unlimited authorization to an international body to create purchasing power and thus use U.S. resources without retaining an ultimate veto power. The Bretton Woods Conference tried to escape this dilemma posed by the existence of the sovereignty of the member countries by limiting the volume of, and meticulously circumscribing the use to which, the funds entrusted to the international institutions can be put. This stultified the purpose of the new organizations. The experience gathered would seem to indicate that it would be preferable to acknowledge the limitations of international organizations at the present stage of evolution. No contributing country should therefore be expected to forgo power to veto any proposal concerning the use of its own contributions. The experience of the first year of the Marshall Plan has shown that, despite much political intrigue, nothing *seriously* untoward—certainly no sabotage—need be expected from this right. A reckless use of the veto power would—after the experiences at U.N.O.—incur such censure as to secure the co-operation needed. As a further safeguard it should be provided, however, that the exercise of the veto over a scheme of development grants or credits should be published with a reasoned statement of the arguments, and also the rejected scheme or request of credit. The common interests of the Western countries should be sufficiently strong, their public opinion sufficiently alive to their problems, to prevent a capricious use of this right. In any case, the alternative, the limitation on the volume and use of funds has shown itself far more destructive of stability than the retention of veto power.

Apart from this special safeguard for contributing countries, membership of the Board should be open to both contributors and recipients. Its members should be appointed by the governments, preferably from among politicians and administrators, not bankers, though it must be supported by a strong secretariat of technical and economic advisers.

In fact the scheme proposed is nothing more or less than a generalized and internationalized form of the Economic Co-operation Administration which could easily be formed by a reorganization of the International Bank. The directors should,

however, *not* be composed of bankers but of men of administrative experience in economics and social development. The problem of international investment is not a banking but a social, political and technical problem. The fact cannot be emphasized enough that no institution, however admirable its character, is worth more or capable of performing better than its personnel.<sup>1</sup>

To sum up. The proposals outlined here aim at the reorganization of the International Monetary Fund into an International Central Bank and of the International Bank for Reconstruction and Development into an International Board for Economic Development. The former might aid countries in overcoming temporary balance of payments difficulties by short-term loans. Credit balances thus created would count as legal tender in the reserves of the Central Banks of the participating countries and would be the equivalent of gold. Its main function, however, should be the offsetting of international cyclical fluctuations. While the Board would normally be charged with initiating a steadily expanding volume of international development schemes, financed by progressive contributions of the richer countries, the Bank would, in case of need, put at its disposal sufficient international cash to expand its activities until the danger of cumulative deflation has passed and direct the purchases towards those deficit countries which are in no need of foreign lending. Intimate relations must therefore be maintained between the two institutions as the Central Bank's activities would have to be curtailed once the depression has been stopped. The main contributing countries (and, in the case of the Central Bank, the recipients of the deposits created) should have veto power over any transaction which might involve their contribution, but the use of veto must be public and reasoned. The new institution would in many respects be similar to U.N.R.R.A., the untimely demise of which (together with the sudden cessation of lend-lease) has so much contributed to our present problems.

The experience derived from functional international collaboration during and since the war encourages some hope. When actual problems have to be solved instead of defending abstract principles

<sup>1</sup> The British influence in the existing bodies with notable exceptions shows the neglect with which the Government has treated the problem of creating an atmosphere in international organizations in which British policies might be expected to win an increasing assent. It is not unfair to suggest that in many instances British views were far less progressive—to the detriment of longer-run British interests—than those of their American colleagues.

and ideologies, the results have been far superior to anything which could be reasonably expected. A strong tradition of practical collaboration has grown up in almost all international bodies on the official (as contrasted with the governmental) level, even in those rent by the dissensions between East and West. As progress is made with economic reconstruction there is no ground to fear that this tradition will not grow stronger. The obligation to explain and to defend national policies before an international expert body itself modifies and improves national conceptions and makes collaboration relatively easier. Even the natural disappointment caused by the rift between O.E.E.C. countries in economic and monetary policies does not invalidate this conclusion. It was caused, as we have seen, partly by the feebleness of the British initiative in Europe and especially at O.E.E.C. and partly by the encouragement of dogmatic *laissez-faire* by the U.S.

It might be asked how such a Board would aid in solving Europe's dollar problem, as most European countries would not qualify for grants. The answer is obvious. The problem of Western Europe is not so much that of an *overall* as of a *dollar* deficit. The despondency about the success of the methods pursued at present arises from the fact that *the measures necessitated by an attempt to close the dollar gap individually might easily set up a cumulative deflationary process which might aggravate the overall balance, and is almost certain to lead to frustration.* Once a reasonable certainty is achieved that markets will exist overseas for European products, which enable Europe to earn dollars by multilateral trade, the rationalization of European production, which is now impeded by the restrictive trends due to the desperate concentration on the single task of eliminating the dollar gap by 1952 nationally (instead of by European co-operation), could be successfully tackled. By the time the proposed scheme is ready to function, the European economy, on the basis of Marshall Aid, should largely be in a position to stand on its own feet even if suffering from a specific dollar shortage, even without those ominous policies of deflation which are advocated in the O.E.E.C. Report. There will be certain countries, especially Greece, Italy, and possibly Germany, which will still be in need of some *net* aid. Their case could certainly be accommodated within the new scheme.

The international readjustments which would still be required would no longer offer insuperable difficulties. The export of

European capital goods to third countries would be buttressed by the immense stimulus of a consciously created demand which might be judiciously directed by the influence of the Board. Nor should it be forgotten that Europe will, by that time, be in no mean position to supply heavy manufactures as economically if not as efficiently as the U.S. because of its lower wage level. In most of these, mass-manufacture is not possible in the same way as in light durable consumption goods. Hence the relative advantage—apart from the overwhelming importance of the capacity to grant credits, which would, however, be overcome by the establishment of the Board—which the U.S. enjoys is, even now, not very marked, despite the failure to devote as yet any appreciable effort to increase Western European specialization and efficiency. And development schemes envisaged, at least at first, will demand much relatively non-standardized goods, though the U.S. industry would also benefit through the increase in the standard of life and the consequent increase in the demand for U.S. products.

The Board should not interfere with internal fiscal arrangements. Whether the budget charge arising out of the annual contribution to international development is raised through taxation or borrowing is left to each participating government to decide. Should any of the contributing countries slide into an inflation the Board should have the right to ask for explanations and publish both these and its own observations. This should be a sufficient safeguard against unilateral attempts to evade international obligations. Those receiving aid, however, should be required to submit their fiscal and investment budget plans to the Board, so as to prevent the emergence of a permanently and unduly unbalanced position.

The proposal outlined has the advantage of enlisting the tremendous increase in U.S. productive capacity which is the direct result of two wars, for speeding economic progress. This excess productive power could not be maintained once 'normalcy'—in the sense of the frustrated efforts of the 1920s—was re-established. It would restore the essential multilateralism of world trade which makes use of the high productivity not only of U.S. industry but also of agriculture for a world in need, instead of stifling it in the name of 'equilibrium.' Indeed, it could concentrate on increasing the rate of primary production unfettered by the recurrent fear of gluts amidst continued starvation of a large portion of mankind. Not only could the

problem of maintaining soil resources be tackled, but the fear that Europe will be left starving as a result of an increase in the standard of life of other continents would be laid at rest.<sup>1</sup>

Bulk purchase agreements which secure guaranteed markets over a long period would in no way be ruled out. Indeed, they might well be concluded under the supervision of the Investment Board prior to the approval of schemes which aim at an extension of primary production. In a world of expanding demand there can be no objection to these agreements as they do not 'discriminate' against anybody. They permit general progress.

On the other hand, the under-privileged areas of the world which are steadily becoming political and social storm centres would at last be shown that there is hope for them through international co-operation instead of being steadily driven towards despairing and sullen revolution. The recurrent Communist taunt that all aid measures are really inspired by the desire to expand and intensify exploitation, and get rid of surpluses which arise out of under-consumption enforced the world over, would be finally laid at rest. The peaceful reform of the system of teeth and claw competition which tries to triumph, not so much through efficiency, as through poverty enforced by unemployment and wage cuts, would have been accomplished. As Lord Keynes put it in one of his characteristic passages: 'So, if they (the bankers) are saved, it will be, I expect, in their own despite.'<sup>2</sup>

Instead of indulging in Utopian demands for political union, for which the countries of the West are in no way ready, the Western countries should get down to extend the practical work of reconstruction which they have begun so auspiciously and work out

<sup>1</sup> The Malthusian problem, however, must receive more serious attention than it has hitherto been possible for the local governments to devote to it, subject as they are to local political pressure

<sup>2</sup> *Essays in Persuasion*, p. 178. Another passage should be read by those who once again wish to have 'competitive' prices through an attack on the 'Welfare State' (p. 176): 'They have not seen what was coming. Some of them have even welcomed the fall of prices towards what, in their innocence, they have deemed the just and 'natural' and inevitable level of pre-war, that is to say, to the level of prices to which their minds became accustomed in their formative years. In the United States some of them employ so-called 'economists' who tell us even to-day that our troubles are due to the fact that the prices of some commodities and some services have not yet fallen enough, regardless of what should be the obvious fact that their cure, if it could be realized, would be a menace to the solvency of their institution.' Unfortunately, the number and scope of those 'economists' has alarmingly increased of late. We are back fighting once more the same old Cabal, and the progressive cause is with its back to the wall. The same arguments are again used which were controverted only a decade ago

measures to help those who are in greatest need. It is from such functional collaboration with its inevitable compromises that common interest and tradition might arise later, which is the condition of closer political ties. These development schemes will, moreover, soften the differences in economic status and social organization which are the most important obstacles in the way of an abrupt unification, a federalization of the countries of Western Europe or of the members of the Atlantic Alliance. It should be emphasized, however, that the personnel of the Institution and the directives given to them by the most powerful Government, the U.S., will be the decisive factor. If, as it happened in many countries, the representatives of the Board make common cause, and derive their information from the most conservative elements of the population, few productive outlets for investment will be found and the funds will be wasted in buttressing inefficient and iniquitous social and economic systems.

#### 4. COMMERCIAL POLICY AND INEQUALITY<sup>1</sup>

It was argued above that organized large-scale international investment financed by loans and grants, represents a far superior alternative to commercial discrimination as a means of reducing the growing inequality in the international distribution of wealth and income. In the shorter run, when neither the proposed investment scheme nor the stabilization plans are yet mature, direct measures to diminish the extreme unbalance of trade between Western Europe and the U.S. might seem advisable.<sup>2</sup> Even in the longer run the U.S., which must necessarily have a decisive voice in the establishment and administration of an International Investment Plan, might prefer to deal with the problem of inequality and unbalance to some extent directly, without the recourse to a relatively larger scheme of gifts or loans. So long as it is firmly borne in mind

<sup>1</sup> Cf. Sir Hubert Henderson, 'The Havana Charter,' *American Economic Review*, 1949; also my papers on 'The Charter of I.T.O.' and 'Britain and the Geneva Agreement,' *Bulletin*, op cit, 1947 and 1948, for detailed criticism of the 'rules of the game'.

<sup>2</sup> The rather dramatized manner in which the recent dollar drain suffered by the U.K. was publicized obscures the fact that Britain covers a greater proportion of her dollar requirements by exports and services than other European countries. It is the magnitude of the trade which singles her out for criticism. Attempts to force all-round balancing would soon uncover the weakness of the whole Western European system, not the least that of Belgium, which now profits from her beggar-my-neighbour tactics.

that only unilateral tariff concessions<sup>1</sup> and permission to discriminate against U.S. goods represent an alternative to grants and investment schemes in reducing inequality, the size of the latter can be varied without additional<sup>2</sup> unfavourable effects on the standard of life of Western Europe and the rest of the world. Any decrease of aid would, of course, represent a loss and raise problems of readjustment. But the direct loss is bearable if new markets are created either by investment schemes or by commercial concessions. It is the secondary loss and the struggle concomitant to the expansion of European exports against active U.S. opposition which threatens monetary disorders of severe dimensions.

If we bear in mind that a solution which attempts to avoid a cut in European imports from the U.S. and to balance visible trade directly, would seem to imply trebling of European exports to the United States, the difficulties in the way of a solution which does not represent a shrinkage of world trade would seem insuperable without a scheme of investment grants. Nor is there, as we have argued, much chance of displacing U.S. exports to third areas in sufficient volume without such a scheme to balance trade triangularly. In those—heavy—goods where Europe has a relative chance (the prospects for an expansion of trade in labour intensive light products are exceedingly dim as most overseas countries try to increase their own output) the lending power of the U.S. would seem to bar progress. It is evident, therefore, that the worsening of European terms (or reduction of imports) would have to be serious, resulting in a considerable further deterioration in Europe. It might be added that the establishment of an effective International Investment Board, coupled with a stabilization scheme would go a long way in reducing domestic resistance in the United States against readjustments involving an increase in the competitive power of European industry at home and elsewhere, which now render devaluation or any other kind of European readjustment aiming at a high level of exports rather than a low level of imports in the longer run so dangerous an undertaking. It would provide a high

<sup>1</sup> Or their equivalent in lessening the market imperfections militating against foreign goods. A campaign to help European products has exactly the same effect as tariff concessions.

<sup>2</sup> i.e. the loss will be restricted to the loss of supplies due to the reduction of the grant (or loan). The additional loss resulting from the worsening of the terms of trade would be avoided.

internal demand, and thus permit shifts in production which are impossible to enforce politically in a period of general depression.

The reciprocal trade agreements sponsored by the U.S. Government have consistently disregarded the unbalanced state of trade between the U.S. and foreign countries. They have contributed little to the rectification of the excess of exports of the U.S. Indeed, the U.S. Administration in defending these pacts has proudly pointed at its success in obtaining concessions from other countries. Moreover, as we have seen, the escape clause which permits the raising of tariffs should imports come in on massive scale and injure U.S. domestic industry (which they are bound to do, *unless U.S. demand increases faster than supply*) has imparted such uncertainty and risk into export trade to the U.S. as to render its expansion—which demands large new capital investment in plant and designing as well as in advertising and marketing—impossible. The peculiar U.S. customs procedure has only set the seal on this.

The U.S. will have to recognize the need for one-sided tariff concessions to Europe, but also for a preferential treatment of European products in intra-European trade, as well as in the trade of Western Europe with complementary overseas countries. Otherwise Western Europe will continue to be at a grave disadvantage with the United States, the industrial development of which was assisted not merely by the existence of a vast domestic market, but also energized by a war which did not touch her territory.

An attempt to lessen the need for U.S. assistance without actually worsening the position of less favourably situated countries would require:

- (a) *one-sided* tariff concessions especially in respect to consumption goods;
- (b) standardization and clarification of customs procedure;
- (c) toleration in third markets, including in Western Europe itself, of a limited degree of preference for European manufactures, the gradual abolition of which (outside the areas which have political connections, e.g. Imperial Preference; or which entered into agreements of close economic collaboration like the O.E.E.C. countries) should be arranged as the development plans elaborated by the new Investment Board mature.<sup>1</sup>

<sup>1</sup> Thus the present short-term problem could be jointly tackled with the preparation for longer-term schemes.



The establishment, first of all, of a more co-ordinated Western European economic system will require certain *temporary* safeguards to preserve the process of co-ordination in Western Europe from outside shocks. We have seen, however, that this relative protection in Western Europe itself cannot be managed by a straight Customs Union because of the grave differences and unbalance between these countries themselves. Thus a preferential tariff system (or a discriminating use of quantitative import regulations) is required. But simple preferences within Europe will not fit the complex relations of Britain with her colonies and the independent dominions. Nor could it give a start to European products against American competition in third markets. Thus the elaboration of a double or treble tier preferential system will be required—in so far as the price system is to be permitted to work—to accommodate the various complex requirements of European reconstruction. Alternatively, discriminating long-term bulk purchase agreements will have to be employed in Europe's relations with overseas countries which would secure analogous advantages of security to European producers. The fact that Europe can provide guaranteed markets for many of the third countries which might grant it preferential treatment, is the reason for hoping that they would be quite willing (provided the U.S. consent could be obtained) to conclude such arrangements with Europe.<sup>1</sup> In this connection it should be remembered that Germany and Japan, not to mention France, are engaged on similar general policies as Britain. A precipitate increase of the international supply of manufactures, especially of capital and durable consumption goods, without a planned expansion of markets might easily lead to such worsening of the terms of trade of Western Europe as to involve, subsequently, a collapse of the reconstructed world economy. If we accept the aim of E.R.P., i.e. that the equilibrium in the Western European balance of payments should be restored as Marshall Aid declines without a severe fall in the standard of life, and should an effective International Investment Board not be established in its continuation, unilateral tariff concessions by the U.S. and also the degree of preference for Western European products would have to be larger.<sup>2</sup> We shall return to this problem

<sup>1</sup> Cf. above on the Argentine Agreement and U.S. reactions.

<sup>2</sup> As the discontinuation of Marshall Aid might easily cause a short-term deflationary spiral in the U.S., further aggravating the crisis all round, the importance of these concessions is even greater.

in connection with the short-term problem created by the mounting deflationary wave in the Western World.

### 5. INTERNAL EUROPEAN PLANNING

The establishment of a strong Western European economic system is not possible on the basis of piecemeal planning by member countries with a subsequent co-ordination of the plans in committee. The result would remain, in the best of circumstances, as it has been in the two years that have passed since Mr. Marshall's speech, a series of unsatisfactory compromises which would leave the Western European economy basically unchanged.<sup>1</sup> The increase in European productive capacity in the last few years has reduced the emergency demand for American supplies. But the real aim, the establishment of a viable European economic system in a well-working world economy, has not been approached and cannot be accomplished by the present methods.

These considerations might have indicated that a strong organization was required to shape and co-ordinate Western European economic policy. The difficulties would in any case remain formidable. The divergence in political and economic viewpoints between the sovereign governments of the member countries is a grave obstacle to any coherent economic policy. Moreover, extremely wide differences exist in the willingness and the capacity of the various member governments to implement any policy commonly agreed on. This is a further obstacle to supra-national regional

<sup>1</sup> Cf., for example, the British Steel Federation's comments on the procedure adopted in the 'functional' committees.

'Clearly the Steel Committee can at present consider only propositions submitted to it by its national delegations. Its powers so far have been limited to approval or disapproval, and it has hitherto failed to approve only one project. It has been clear that, once a complete national programme is presented, its component parts have already achieved a measure of rigidity which requires considerable pressure if alterations are to be made

'The Committee, by virtue of the fact that every action must be taken on a basis of mutual agreement, is finding it difficult to reject any particular project, and unless some procedure be found to amalgamate development plans on a European basis, the actions of the Committee will tend to become purely formal recognition of political pressure, and bargains made behind the scenes. If such is the outcome, the O.E.E.C. will fail in its objective' (British Iron and Steel Federation *Monthly Statistical Bulletin*, May 1949, p. 6.) The Reports of these bodies seem even more sterile statements of the obvious without any sort of material addition either to knowledge or to action than the worst products of international committees when faced with intractable problems. Surely immense advantage could have been gained if the Secretariat had submitted reports on the requirements of the region as a whole. The veto power of the member countries in Council must be retained at this stage. But steady public discussion and pressure must be exercised in order to secure modifications in the national plans or at least enforce a public discussion of those plans.

co-operation because if there is no guarantee that certain vital supplies will be forthcoming from within the region as planned, countries such as Britain (but also Belgium and Germany), which depend on foreign trade, would hardly dare to rely on paper promises. Nevertheless, if Britain is to regain the initiative, certain calculated risks must be run, provided that some safeguards are obtained both in respect to U.S. policy and European production plans.

The first need is to establish an effective organization to undertake the necessary work. A committee cannot do a job even if ably assisted by a secretariat. It was clear at the 1947 Paris Conference that if Britain so wished she could effectively initiate European planning and obtain U.S. aid in its enforcement. The opportunity then not taken will now be much more difficult to recreate. The menace of a complete breakdown of European recovery might, however, help in persuading the U.S. authorities to throw their weight behind this reform.

There is no possibility, however, for success in persuading others if 'soundness,' niceness, or, at most, the ability to 'square' will be the chief requirements in choosing British representatives. The O.E.E.C. is not an inter-departmental committee on which—subject to special loyalty to one's 'house,' the Department—a common loyalty to the 'School,' the Government secures the basis for compromise. The immense importance of choosing representatives who believe in the basic correctness of the British approach can hardly be exaggerated. The frivolous mood which ignores the need of superior knowledge of modern problems and methods on the part of the spokesmen of the isolated British Government when it is of vital importance to modify the policy of European governments has no place in the present precarious condition of Britain.<sup>1</sup> This country can no longer afford splendid disregard of foreign opinions. Every opportunity must be taken to spread economic enlightenment and avoid the disasters of 1929–31. It is a sad reflection on the memory of the world and the conscience of experts that those are loudest in demanding deflation whose activities in that not so distant period so much helped the rise of Hitler.

A more forward-looking plan on the part of Britain than that published last year, envisaging some real sacrifice in favour of less

<sup>1</sup> Cf. Chapter 5.

happily-placed European and overseas countries, might serve as the nucleus of a new departure in reorganizing the world economy.<sup>1</sup> Unlike the Bretton Woods institutions and rules, the establishment of an International Investment Board based on the Fourth Point of President Truman's inaugural address gives a definite chance for the re-establishment of a multilateral system, and one of which utmost use should be made. The clear demonstration of the waste of hard currencies and of the uncertainty of performance of the *laissez-faire* approach to European reconstruction—even where, as in the case of Belgium, it did not lead to social disintegration and scored some unstable and transitory gains—might convince the U.S. Administration that direct domestic controls are required to re-establish a working European system. The British Government should, at the earliest date, utilize these important changes in the background to obtain a more secure foundation for European reconstruction on which its plans depend.

The establishment of monetary or customs unions would, as we have seen, inevitably cause large-scale dislocation, bankruptcy and unemployment without any immediate tangible advantage. Moreover, so long as the relative monetary tension in different countries is so largely divergent, a unification of currencies would tend to transmit the inflationary tension of the weakest member to the rest. A convertibility of currencies into gold would, conversely, tend to spread deflation from one member to another. A premature attempt to 'liberate' trade, however, would undermine the system of controls of the country which has succeeded in maintaining stability, and,

<sup>1</sup> There is reason to believe that the U.S. authorities were, in the autumn of 1948, willing to accept a British plan involving a smaller decrease in Marshall Aid than was contemplated by the British Government, which subsequently had to be twice increased under the most unfortunate diplomatic conditions. At any rate, the British statement on the Four-Year Plan did not refer to any limitation imposed on its investment plans by the refusal of the U.S. to entertain higher figures. In that case a much more flexible approach could have been adopted and U.S. criticism and disillusionment on account of the 'bilateral' character of the British plan avoided. The present acute crisis and disagreement might not have arisen. This shows the importance of a reform and democratization of the planning machinery now exclusively in the hands of a small circle of experts. The reduction by \$300 million in Britain's request won no laurels in America. The reduction of re-equipment of industry by almost a third and the effect on the European plans was exceedingly unfavourable. There is some indication, of course, that additional borrowing and investment in colonial projects is contemplated, for the programmes envisaged in the Colonies could certainly not be accomplished without vastly greater investment than was contemplated in the balance of payments estimates. But even in this respect the approach to the International Bank was exceedingly languid. Somewhat greater care should have been taken in trying to persuade the Americans to underwrite, at least in the form of a loan, this expansion.

lead to, in private cartel arrangements, to avoid the readjustments. Sir Stafford Cripps' firm stand at O.E.E.C. prevented irreparable damage and limited the transferability of European balances to manageable proportions.

The first condition of success in any European reorganization is guarantee of the participants that the plan elaborated by common agreement will in fact be executed. This is a point on which a strong statement by the O.E.E.C. is indispensable without delay. The attitude of doubt to which the O.E.E.C. report restricted itself, however courageous, is not a policy.

Secondly the dilemma between supplying needs as they arise and the ultimate aim of securing balance in international payments, which has plagued the Economic Co-operation Administration and O.E.E.C. since the beginning of Marshall Aid. How to aid the needy, how to avoid competitive deflation without encouraging the reckless is a problem which must be faced and faced immediately. Some parts of the U.S. Administration and most of the *laissez-faire* governments in Europe have a stereotyped answer to this problem. Restore convertibility at least in respect of the 'conditional' aid (i.e. that part of Marshall Aid which is granted subject to the recipient country making an equivalent grant to other members of O.E.E.C. in its own currency<sup>1</sup>) and restore 'competitiveness' in European trade and all will be well. The virtuous, the cheap and efficient would be rewarded by increased dollar allocation; the sluggish workers and reckless spenders bent on establishing a Welfare State, thus destroying incentive while increasing consumption (especially of spectacles and false teeth) would be duly punished. But this view tends to neglect that some European countries were much harder hit than others and thus objectively need more aid. And it argues as if we lived in a barter economy which is fully employed, i.e. where misguided monetary policy leading to unemployment cannot produce the impression of high competitive ability through low wages and lower consumption (because of spreading unemployment).<sup>2</sup> As we have demonstrated, it is the *comparative*, not absolute, position of deflation (or inflation) that determines—in conjunction with the U.S. position and measures—the short-term balance of payments. The *laissez-faire* nostrum on closer analysis turns out to be unjust, haphazard and destructive of any collaboration in Europe.

<sup>1</sup> Cf. above, Chapter 2.

<sup>2</sup> Cf. the comparison between the Belgian and Dutch performance in recovery, Chapter 3

It might have been invented by those who desire a breakdown of the European recovery programme.

If we recognize the futility of enforcing the short-run balancing in international payments as the criterion of European aid, however, new norms for its administration and distribution have to be elaborated. From the beginnings of the Paris Conference onwards, the calculation and allocation of aid, including intra-European, was based mainly on estimates of prospective balance of payments deficits *given* the policies of the countries receiving aid. Neither the possibility of using the aid to enforce the maximum increase in European production, nor questions of equity between the Western European nations were considered.

These are the criteria to be accepted. This presupposes a very much greater degree of conscious economic planning and co-ordination than seems hitherto to have been considered feasible. But the present policies have left the European problem hardly changed. While any suggestions that the Europeans could tackle it unaided either by way of devaluation and other monetary manipulations or by 'federating' must be repudiated, it seems both politically and morally impermissible to hope for a solution coming entirely from the outside by some form of U.S. help or other.

At the end of the war high hopes were entertained that substantial advances could be obtained by regional planning in Europe. All Western countries contemplated a substantial increase in total production and planning for increased specialization, and a co-ordination of investment plans would not necessarily have demanded the displacement of existing vested interests, but merely a selective increase in productive capacity.

The history of the last two years has shown that these hopes have, to a large extent, been disappointed. There is no need to repeat the thorough and scathing review of the E.C.E. of the Western European plans in this respect.<sup>1</sup> The analysis shows that little, if any, discrimination has been used, even between sources of imports to be substituted by home production, and that, in general, there has been in all national planning a trend to national autarchy.

The difficulties which account for this disappointing trend are to some extent attributable to the fact that planning means all sorts of things to different people. Between the completely nationalized

<sup>1</sup> 1949 *Report*, op cit, Chapter 8, esp. pp. 187-9 and Tables 105/6.

economies in the East, the economies of Britain and the Nordic countries where investment and production is largely carried on by private interests which are, however, effectively controlled, and Germany and the Latin countries where a conscious effort to free market economics is being actively pursued, we have extreme differences. One of the consequences is that the implementation of any plans elaborated will be uncertain. Other countries are therefore unwilling to rely on theoretical plans in their own plans.

Thus the temptation to substitute home production for imports is very great. Those governments who maintain controls will be especially tempted, nor is the trend less marked in free market economies. Here the high risk of retaining export markets will play a rôle. The trend towards national autarchy has further been increased for ill-considered military reasons. After the experience of the last wars, a decided preference has been given, even in the West, to the expansion of heavy industry, though effective sources of supply exist. The similar tendency in the East is somewhat more justified objectively as such sources do not exist, and as the West has introduced an export restriction policy.

The danger of national autarchy instead of regional planning has increased by the fact that while food and raw materials imported from overseas are difficult to replace, manufactures imported from European territories could be more easily produced at home. Moreover, the attempts of European producers to charge discriminatingly high prices to other (European) 'soft' currency areas renders the displacement of such supplies by home products in the short run profitable. The report of E.C.E. notes that such increase in intra-European trade as has been planned by the O.E.E.C. countries comes mainly from the expansion, surprisingly enough, of raw material or similar imports, e.g. processed petroleum products. Trade in machinery has to be reduced, even within Europe, despite the fact that the discontinuation of a large volume of such imports from the United States is contemplated. Published plans of production and trade show definitely a tendency towards diversification of industrial production which is, on all accounts, already very much diversified in Europe, and needs standardization and concentration. Only in so far as this replaces imports from the United States and only if a sufficiently large demand were available, could this process be economically justified. It must be added, however, that the pre-war

preponderance of Germany in most of the heavy industries, including chemicals, seems politically intolerable for most of the Western European countries for the future.

Nor must we underrate the disastrous consequences in this respect of the combination of a serious distortion in the income pattern in Europe through inflation, currency reforms and so on. The result is that the distribution of income and money capital has little, if anything, to do with the present situation and its requirements. Some economists suggest that these anomalies could be removed and the pattern of monetary demand most efficiently adapted to requirements by a renewed monetary reform. Unfortunately, this view does not take into account the present political situation in most European countries which rules out such an attempt. Indeed, we see in many countries, e.g. Germany and Italy, a conscious attempt to increase the inequality in the distribution of national income in the hope of increasing the rate of investment. The result is that luxury trades are stimulated and overall productivity decreases. The productive structure in some, at least, of the European countries has been adapted to mass consumption, which the monetary consequences of the war and mistaken reforms have destroyed. This also means a large waste of productive capacity. The competitiveness of European industry in overseas markets is further menaced. The only possibility to remedy this situation without violent convulsions would be to institute effective controls which would channel demand away from certain industries and concentrate it towards innocuous uses, i.e. uses which do not absorb scarce real resources. It is obvious that this solution has been rejected in most countries. On the other hand, it seems foolish to expect that a return to price mechanism would enable us to make any progress; even if vested interests would not oppose their ruination (including Trade Unions) we would still come up against the inherent difficulties created by oligopoly. The experience made with Benelux and the Franco-Italian Pact shows sufficiently the hopelessness of this procedure.

Even if the O.E.E.C. plans are viewed with due allowance to these extreme difficulties, however, grave disappointment must be expressed at the failure. The problem is how to stop this trend which seems to be inherent in modern European development.

For the first period, regional planning and 'unification' must



be restricted to measures which do not cause widespread losses and unemployment in any of the participating countries. This still leaves ample scope for increasing the complementarity of the participating countries, as each is engaged in increasing its production by anything up to one-fifth, in the next four years.

An important step in this direction is to undertake a thorough investigation of the possibilities of obtaining faster and greater increases in productivity by switching investment. It is probable, for example, that the general mechanization (as contrasted with the introduction of special devices due to technical progress) of British agriculture has long passed the point where returns decrease.<sup>1</sup> A switch towards helping French agriculture in increasing its productivity would unquestionably benefit Europe. Conversely, certain of the heavy industrial expansion contemplated by France would duplicate British production, or at least does not promise an equivalent increase. Within certain limits dictated by security and social reasons, investment plans of each of the member countries could be modified as to result in a greater yet balanced increase of production of the area as a whole while contributing to the balancing of *intra-regional* exchanges. This latter is necessary since otherwise intra-regional trade results in losses of gold to some countries while others receive grants.<sup>2</sup> The dilemma might be solved by concluding long-term supply contracts which secure part of the increase in production to the country which made the original investment possible.

The basic principle of inter-regional European planning is to concentrate on the export of high-value non-essentials to America as much as possible, but not to restrict unduly inter-regional purchases of non-essentials (subject to the above qualifications). Balance of payments considerations should as much as possible be eliminated within the region. Unfortunately, monetary divergences between member countries will for some time limit the complete implementation of this principle, unless barter exchanges can be arranged to eliminate monetary disturbance. Such reciprocal exchange arrangements might promote investment projects as they give some assurance of obtaining the products resulting from the investment.

In the division of Marshall Aid much greater weight should therefore be given to the investment plans submitted as the ultimate

<sup>1</sup> Cf K A H Murray, 'The Outlook for British Agriculture,' *Lloyds Bank Review*, January 1949, esp pp. 62 and 72

<sup>2</sup> e.g. British payments to Belgium while French deficits are financed by grants.

condition of increasing European productivity and restoring economic balance. Instead of an automatic transfer arrangement in respect of the conditional aid given, which encourages deflation, a return ought to be made to so-called offshore purchases in Europe, i.e. purchases by the E.C.A. Administration of essential supplies against dollars from Marshall Aid funds. This would provide an additional incentive to conform to plans laid down in co-operation. It would avoid the present dilemma.

Certain general rules might be suggested: first, the attempts should, in the beginning, be concentrated upon large investment projects such as agriculture, steel, engineering and textiles; secondly, the arrangements must be made by governments and not by private industry, and their execution supervised by governments; thirdly, the criterion should be the increase in total production and inter-regional exchange. Colonial development projects should also be much more centrally co-ordinated to secure the economies of large-scale production planning.

Apart from new investment certain measures of standardization and rationalization might be attempted: first, it would seem important to establish inter-regional standards, especially in capital goods and components, similar to what is attempted in the motor-car industry in Britain; secondly, certain research and development schemes might be regionally pooled and specialization attempted, e.g. in oil refining and chemicals; thirdly, a first beginning might be made towards a regional export policy by establishing joint export promotion agencies outside the region, especially in the U.S., instead of trying to engage in oligopolistic competition. All these ventures, however, must be made under strictest Government supervision and presuppose a complete reorganization of O.E.E.C., strengthening its authority.

Western European planning has, to some extent, come to grief because in discussing national plans two vital considerations have been left out of account. The first is that of intra-European equity. While immediate efficiency demands the strengthening of the strong, equity demands that the less developed countries should be given a fair share in industrial expansion on which their ultimate prosperity depends. The threatening dollar position should lead to priority being given to the first criterion. But without some compensation, which holds out hope for future progress and

immediate benefit, compliance with the evident needs of the region as a whole can hardly be expected.

The second, and perhaps even more important, failure was in realizing that *national* investment, even in the so-called planned economies, is mainly carried out by individuals and firms at their own risk, for their own profit. The disproportionate risk of trading in foreign markets will tend to stimulate them to concentrate, so far as possible, on building up secure home bases. There seem to be exceedingly few industries, e.g. Swiss watches, Swedish ball-bearings, in the case of which a large volume of exports is sustained without a considerable home market. In the home market, moreover, as a rule existing firms developed on the basis of cartel agreements or tacitly, instinctively refraining from all-out price competition (oligopoly). They limited their risk by distributing their output over a large range of products, regardless of the fact that this increased their cost of production. It is difficult to feel confident that these firms will, without some outside intervention, pursue policies radically different from those in the past which have produced the present unsatisfactory position. Apart from the fact that their present policy increases their profits, their desire for greater security will lead them to distribute risk among different products, or, at least, different types of the same product.

Wartime experience in Britain might perhaps suggest a method of tackling this problem. The need to shift manpower from unessential industries to essential factories, combined with the necessity to minimize imports of raw materials for less essential purposes, enforced a large scale and quick reorganization of the industrial structure during the war. At the beginning, firms were left to fend for themselves. The result was that productivity fell abruptly and prices rose, as all firms, despite the curtailment of their supplies of raw materials, tried to remain in business. As the release of manpower in consequence was disappointing, the Government was soon driven to reinforce this policy by reorganizing industry. Concentration schemes were elaborated under public supervision and selected factories were closed down altogether, while others were permitted to remain in full production, despite the decrease in supplies and manpower. Compensation schemes were elaborated to permit the closed down firms to exist. Some of these schemes were ill-conceived because they did not take into account the advantages gained

by firms which continued in production. But in certain instances, where the individuality of all firms was, for the period of the war, altogether suspended, even this difficulty could be overcome.

The present problem is of course radically different. What we have to do is not to close down firms temporarily, but to modify their structure or even to eliminate them altogether. Nevertheless, it seems obvious that the wartime experience has some relevance in this respect. During the amalgamation movement at the beginning of this century the firms which took over and closed down smaller and more inefficient producers, had also provided some compensation. Without some such special scheme, we shall not get very far, despite the monotonous reiteration of excellent principles by all and sundry. One of the functions of O.E.E.C. would be to establish such reorganization and compensation schemes, financed by the Marshall Plan counterpart funds. In this way, governments and firms could be provided with an incentive to fall in with plans elaborated from a regional, as against a strictly narrow national, point of view. It may be argued that an 'opening' of trade would accomplish the same end without 'bribing' inefficient and monopolistic interests. But the general deflationary repercussions would probably do more harm than good. And in practice no government would contemplate plans which result in serious dislocations in their own country. Thus the elaboration of intra-regional and intra-industrial compensation schemes will probably be an essential condition of a closer economic co-ordination in Europe.

A ministerial council on the spot, supervising in detail the progress of the implementation of the plans is the first requirement. This has been recognized by the U.S. authorities. It has yet to be acted upon.<sup>1</sup> The periodic meetings of finance ministers is not equivalent to serious co-ordination, but only to painful compromise, after problems already reached a critical impasse.

Provided some more definite and favourable picture emerges of the prospective policies of the U.S. and our European partners, this country should contribute its share in carrying the burden. The British Government should aim at a much greater increase in its investment programme and, consequently, of productivity than is indicated in the published documents, even at the cost of limiting consumption temporarily. This would permit the contemplation

<sup>1</sup> The Council of Ministers established lately in no way meets this need.

of a greater increase in *the exports of capital goods* to European countries and of an increase in *their dollar-earning capacity* by an *increase of their exports to extra-European countries*. Alternatively, more imports could be planned from European countries and balanced by a compensating increase of *British capital goods exports to overseas countries*. Of course, this procedure would leave extra-European countries with a considerable dollar deficit, as they would have to pay for British exports in dollars. The *closing of this ultimate-non-European-dollar gap* would depend on U.S. policy in international investment and commercial policy.

The advantages of this procedure are to show the Americans that Britain is willing to do her utmost to promote European recovery, but that this would mainly depend on U.S. policy. Such a British initiative would have given some incentive to the Europeans and the Dominions to co-operate with Britain; and their public opinion, a factor of immense importance—as the Soviet should know to their discomfiture—would have been mobilized in our favour.

If satisfactory agreements can be secured on the first two points there is every hope that British productivity could be increased by 10 per cent more than contemplated and British exports attain a level of 165–175 per cent of pre-war. Unless such agreement can be secured it is questionable whether any of the major assumptions of the plan and therefore its targets can be fulfilled. In particular a continuation of the U.S. recession would certainly render the export targets unattainable. A lack of co-ordination in Europe, especially between Britain and the Bizone, would also destroy the premise of unchanged terms of trade.<sup>1</sup> In any case it should be obvious that Britain would have to make some sacrifices to help poorer countries in order to lead in the establishment of a more orderly world. The devaluation of currencies, general or individual, would in the longer run hardly modify these basic considerations. A competitive *sauve-qui-peut*, whether it takes the form of devaluations or deflation, does not provide a satisfactory solution, i.e. a solution which minimizes the loss suffered by the poorer countries,

<sup>1</sup> On any hypothesis the strict bilateral balancing put forward by the British Government at the end of 1948 can only be deplored, however necessary it may be to allow for it as a *pis aller* after all efforts at agreement have failed to produce satisfactory guarantees, both within and outside Europe. In that case, however, much farther-reaching reconsideration of policy will be required.

including Western Europe, in consequence of the readjustment of their balances of payments.

In particular the British Government should strenuously advocate the co-ordination of international investment plans with guarantees by Western Europe of markets for such increase in production as will be achieved. There has been much incoherent and contradictory criticism of what is falsely termed bulk-purchasing by the British Government.<sup>1</sup> Charges were made that such agreements were exploitative<sup>2</sup> and at the same time that they resulted in 'losses.'

Reciprocal purchase agreements permit the extension of production in both regions and eliminate the social costs involved in frequent readjustment. Unless extreme mistakes are committed in the choice of the products the losses involved in this 'increased rigidity' are lower than the gains resulting from the reduction of the risk of extending production. *And it is this extension of production which is the crux of proposals to enter into reciprocal agreements.* Britain and Europe should try to avoid competing for a *given* world market but organize for an *increase* in the production of primary products against raw materials. It should not be forgotten in this context that the inelasticities of demand and supply which characterize the markets of primary products are only a source of strength for the producers when there are scarcities. Abundance results in weakness. This fact is well understood and results in a tendency to restrict—or not to expand—production more than justified by current prices for fear of overstepping the danger limit. The elimination of this fear is essential, if the threat of continued shortages is to be overcome. But it could only be overcome by long-term guarantees.

The period immediately ahead, when the extreme scarcities of foodstuffs due to the crop failures in Europe have already been

<sup>1</sup> Cf. above and *The Times*, June and July 1949.

<sup>2</sup> The word 'exploitation' not merely has a strong negative emotive connotation but is also normative. Whether or not British observers including eminent economists should use such terms in this connection is a question which we need not consider from a political point of view. It will be sufficient to show that the 'scientific' criteria implied in its use as a noun will not bear closer investigation. The charge that the policy of long-term reciprocal purchase agreements is 'exploitative' must mean either that Britain will try to buy under the *free* world market price or sell above it. But it would seem odd to assume that the actual 'world price' is fair, unless it is based on full employment, perfect competition and perfect foresight, and the other even less realistic assumptions (e.g. perfect income distribution, etc.) If the world price is not determined in this way and if a long-term purchase *eliminates uncertainty* (which at the margin of production is *extremely high*) a direct comparison of the guaranteed price with the (fluctuating) world market price is impermissible. This is one of those cases where the thoughtless use of static economic models for the elaboration of practical policy recommendations makes such mischief.

eliminated and the increased competition of manufactured products has not yet fully materialized, will probably provide a good opportunity to prepare the basis for such long-term arrangements and dissipate suspicions of 'exploitation.' At the same time measures should be taken to reduce as much as possible a head-on clash between the European exporters' manufactures by stimulating planned development, i.e. demand for their products. It is in this period that an occasion will arise to prove the superiority of long-term planning. What Western Europe—in co-operation with the U.S.—should attempt is to secure long-term arrangements which continue development programmes with an increase in the volume of mutually beneficial exchange of commodities. The manufacturing countries should refrain from making use of the possibility to drive a hard bargain or even to acquire products at such lower prices as they could obtain under comparable circumstances in 'free markets.' For Europe and this country the maintenance of a steady expansion of foreign trade at equitable terms is far more important than any gain they could obtain by buying in the cheapest market. The goodwill which might be thus secured would stand in good stead when it comes to the next phase of the development of the world economy, i.e. the projected vast increase in manufacturing capacity in Western Europe and Japan.

In particular the present equivocal policy towards Eastern Europe will have to be cleared up. Should recent international tension decline, the problems of the West could be eased by intensified trading with the East. If the order of magnitude of Eastern surpluses is small, and can be expected to decline as a result of the plans for rapid industrialization which are carried out at present, in certain key products, e.g. timber, meat, coarse grains, potential productive capacity is substantial, even relative to the vast requirements of Western Europe. It is unlikely, however, that these potentialities can be made effective without at least short to medium credits to the East. So long as a general settlement or at least a more extensive *modus vivendi* is not reached, it is difficult to envisage such arrangements. As soon as an agreement to disagree peacefully is arrived at, these possibilities should be explored. They would materially lessen the need of Western Europe for overseas supplies and at the same time increase the scope of European markets, thus relieving the pressure of the terms on which Western Europe can obtain food

and raw materials from both sides at once. The sales pressure and the pressure for supplies would equally diminish.

Energetic action on these lines should enable the countries of Western Europe to remodel slowly their productive structure, lessen their competitiveness, increase their complementarity and further international specialization. In combination with the measures already discussed promoting stability and development, this would so recast the comparative cost structure in relation to the U.S. as to permit Europe to balance her trade at a high level of real income and a high level of exports to overseas areas. This would enable the U.S. to discontinue direct aid to Europe without fear of such a sharp decline in the standard of life of the population as to endanger political stability.

There are indications that a growing section of opinion in the United States realizes that the Marshall Aid Programme alone will not restore harmony in the world economy. It is to that section that Europeans must turn. The (temporary) measure of discriminating preference granted to Europe—involving a double system of preferences for the Commonwealth—would be the exact equivalent to public relief in internal social policy: they would enable Europe to obtain first, better terms of trade, subsequently to reorganize her productive structure, and finally to dispense with all these special 'props' to her economic system. Europe's position as the second of the 'great workshops' of the world could be re-established.

Given an expanding world economy buttressed by international measures to sustain economic activity and raise the standard of the less fortunate areas of the world, given effective European co-ordination, this is certainly not impossible. It is a delusion to hope, however, that Western Europe can by itself solve the dollar problem by returning to the 'market' system, increasingly vitiated by monopoly, challenged by the Trade Unions and stultified by restrictive monetary policy. An attempt to do so would—like the Great Depression—set in train political and social movements which would inevitably end in war and the annihilation of the Western conception of life in vast and precious parts of the globe. The utmost efforts must be made to obtain U.S. co-operation to stop by collective action the deflation which is threatening to overwhelm the non-Communist areas of the world.



## 6. BRITISH POLICY

It would be clearly impossible to sketch out in detail the changes in British policy needed to make a full contribution to the implementation of such a programme. The analysis of the policy pursued recently suggests, however, that drastic reform will be necessary even in the best circumstances if Britain is to play her part. Not merely must the British economic plans for the next few years be recast so as to give a much higher priority to the need for effective collaboration and especially for co-ordinating investment plans with the other countries of Western Europe; it is also obvious that vigorous measures would have to be taken to enforce at any cost a much faster increase in investment and productivity than has been contemplated.

1. Selective controls both over prices and allocation must be re-established, because they enable pressure to be exerted on entrepreneurs without general deflation. But both these and the existing controls must be put on a completely new basis which permits incentive to be given to progressive and efficient managements. No general rules can be indicated from outside the Government, as the structure of industries varies considerably and the method used must be adapted to meet the peculiarities of each case. There can be no doubt, however, that, given the will, sufficiently elastic and nevertheless far from arbitrary formulae can be elaborated—if the determination is there. Nor can there be any question that that determination has hitherto been lacking. The hesitancy in getting Development Boards going must be overcome, and the tendency to appoint respectable and representative rather than strong independent chairmen reversed. An increasing part of the expansion in productive capacity should be devoted to internal and external investment including contributions to International Investment Schemes.

2. The system of exchange control must be tightened and capital movements which are of a flight character prevented even within the sterling block. Action must also be taken to stop commodity leakages to the dollar area. This certainly has not been pursued with any semblance of energy.

3. As a short-term measure, steps should be taken by international action to stabilize the price of raw materials. It is inexplicable why

steps have not been taken either to secure U.S. co-operation in intensifying Government purchases or in default of it to stabilize prices through British intervention. The dollar proceeds would be increased as a fall in price does not induce increased purchase. The price of the raw material has little influence on the manufactured product. This shows how little forethought was given even to this vital problem of the sterling area.

4. Investment plans should be further rationalized and the building programme used with greater determination to increase labour mobility.

5. The stabilization policy should be broadened in agreement with the Trade Unions and energetic action taken for a speedy reform of wage structures and work conditions which prevent an increase in productivity. The Trade Unions should by now have recognized that uncorrelated collective bargaining cannot promote an increase either in real wages or in the share of labour in the national income.

6. Measures will have to be taken to direct exports so long as the great divergence in the monetary tension between countries remain. Once the immediate danger of a cumulative deflation has been overcome and a general agreement reached on the various schemes to maintain employment and facilitate the closing of the gap in Europe's balance of payments, partly by investment schemes and partly by changes in commercial policy, a general realignment of currencies by devaluation against the dollar will have to be undertaken. This will not render exchange control unnecessary for long years to come, but it will, if undertaken as part of a general settlement, ease the work of controls.

Britain went through the same hesitations in the phoney war period as before these recurrent exchange crises. Even after Dunkirk months were lost in making really full use of the enthusiasm and determination of the masses by relying on futile appeals and exhortations instead of giving a firm lead.

Unless Britain shows resolution in sacrifice, and capacity and willingness in co-operation, she will not be able to regain her initiative and the twin method of co-ordinated world expansion and regional reorganization on which the unity and strength of the Western World depend will not be realized.

## THE ALTERNATIVE

### YEARNING FOR UNEMPLOYMENT

'The Chancellor seemed to rule out in advance any hopeful and constructive action—except more import cuts. No reduction in wages, no reduction in the standard of living, no unemployment, no economies. nothing.'—City column in *News-Chronicle*.

These proposals consist of nothing more novel or ambitious than the extension and intensification of the policy inaugurated by General Marshall and Mr. Dean Acheson, from which the Western World is in grave danger of straying. That policy in its turn was merely an application to the international scene of principles which have long been accepted in internal economic and social policy of mitigating the evil results on the distribution of income and wealth, and on social security of the unfettered market struggle.<sup>1</sup> They are, however, certainly more complicated and more difficult to administer than the 'dash to freedom,' the 'setting the people free' which seem to be advocated with such fervour by the majority of economists even in Britain and greeted with enthusiasm by the Conservative Party. The methods put forward here demand hard and intelligent work in ascertaining the facts, and creative enthusiasm in devising methods by which we can overcome the obstinate problems created by the war, and the consequent revolutionary shift in the balance of economic and political power. It is so much easier to say: 'trust the price-mechanism, resuscitate the rate of interest,' and to proclaim that 'equilibrium' must and can be attained without hardship, if only we do nothing.

But the elegance and ease of that solution is a frightful sham. The orthodox economists seem to use words not to elucidate but to distort their meaning. The return to 'equilibrium' or 'competitive prices' in fact means a struggle forcing all down a deep pit by cumulative deflation. Prices, as one cannot emphasize strongly enough, are also incomes. A competitive cutting of incomes does not yield equilibrium in any meaningful sense of that word. The

<sup>1</sup> One can as little (or even less) talk of 'competition' in the sense of the word usually employed by economists in the international as on the national scene. Monopolistic elements far from being the exception must be regarded as the rule.

money cost structure will not—as the German currency reform of 1948 shows—correspond to the real cost structure. What will happen is that we shall begin to take part in the old *dance macabre* of deflation which led from 1929 to 1931 and on to Hitler's victory in 1933. At the moment Britain and some other European countries are sustaining by their deficit the *laissez-faire* deflationist economies. Once they turn to the same tack and begin to cut incomes, only the exhaustion of savings by losses in the strongest economy will check the downward plunge. No one has the right to suppose and pretend that during a deflationary spiral investment in Europe will increase. Thus the true readjustment of the Continent through increased efficiency will be indefinitely postponed.

Nor must we forget that we are now confronted with a large Eurasian territory where they will not dance according to the orthodox tune. If we are at the moment fortunate enough to be buttressed against this influence because of the fear of the secret-police-state, we must not tempt fortune by undermining faith in the basic justice of the mixed economic system under which we live and its efficiency in securing a stable prosperity. For all their wartime professions the orthodox economists have suppressed or forgotten everything they have learned or ought to have learned in the last twenty years. They do not even live up to the orthodox canons in their mischievous propaganda. Those canons would demand a sharp increase in demand in the United States to facilitate the balancing of international trade. For all their posthumous reverence (at any rate in this country) Keynes might not have lived at all.

At the approach of the twentieth anniversary of the great Wall Street crash we are, once more, confronted with an emergency of a similar potential nature. Indeed, the shift in economic power, the enormously greater inequality in the world, combined with a much smaller capacity to resist economic pressure could produce a far more serious breakdown than in the earlier period. True enough, the United States is in a 'sounder' condition, and there is no pressure for liquidating a vast superstructure of banking loans to producers, consumers and, not the least, speculators. On the other hand the growth of that country was so phenomenal as now to demand high statesmanship to preserve equilibrium even without such additional handicaps. To achieve year in, year out, the *net*, additional investment of some \$30,000 million in the knowledge that success itself

will cumulatively increase that figure, is a task almost impossible to envisage. These considerations indicate also the weakness of the 'liberal' Keynesian approach to full employment through compensatory policies without a vast basic investment programme and some key controls to check speculative excesses. While it might not be difficult to speed up, or slow slightly existing projects, the fitful execution of *ad hoc* spending plans or even sudden changes in taxation to fit the vagaries of private investment seem technically difficult.<sup>1</sup>

It would only be too easy to throw in the sponge and produce a gloomy forecast on the inevitable self-destructiveness of the American so-called monopoly capitalism, and to prove by quotations from Senator Taft or orthodox economic experts that the class structure in the United States, the inherent social dynamism of a community which is dominated politically by a broad class of small entrepreneurs feeling menaced by Big Business, Big Labour Unions and the extension of Government functions—the increase of taxation—cannot produce economic enlightenment even on the domestic scene, not to say in international economic relations. The writings of those economists whom Keynes castigated so venomously and so unsuccessfully twenty years ago seem fully to support a pessimistic interpretation of what is to come. Despite the almost complete unanimity about the possibility, indeed necessity, of Governmental anti-depression measures, we can observe continued fumbling in the dominant economy of the West. An incredible victory of obscurantism threatens, parading under the guise of anti-inflationism. The increase in the adverse balance of payments of Britain due to deflation elsewhere is attributed to inflation without a shred of evidence in price or wage-movements. The demand for the conscious creation of mass-unemployment, for active deflation is cloaked in a call for adjustments to a buyers' market, as if the decline in purchasing power and willingness to buy were not a direct consequence of this unholy propaganda.<sup>2</sup> More than the most fanatical Communists, it is the orthodox economists who preach class war and wish to reverse the consequences of the rise of Trade Unions to

<sup>1</sup> Cf Chapter 4 on President Truman's endeavour to go beyond this concept and secure adequate powers to control secondary speculative inflation.

<sup>2</sup> It has been pointed out by Government spokesmen, e.g. Mr D. Jay, that the demand of the Conservative Party to end the policy of price and wage stabilization as a means of rectifying the balance of payments crisis can only be interpreted as a demand for mass-unemployment as otherwise it would result in higher wages and decreased competitive power abroad.

equal power with the employers by deliberately producing misery. The evolution of a socially balanced community in which conscious agreement must take the place of one-sided dictation is to be reversed. All this is served up in moderate language, with profuse protestations to the contrary, and must obviously increase the confusion due to the inherent complexity of the problem of employment control in a mixed society.<sup>1</sup>

It would be a mistake to suppose, however, as some complacently seem to do, that the 'classical' methods of 'curing' the crisis will not 'work.' They will. Competitive deflation must also come to an end one day. And the unemployment and general cutting of the standard of life, the smashing of the 'Welfare State' now regarded with such venomous hatred will certainly reduce imports. The fact that exports will also be reduced because of the reduction of incomes abroad only retards, but does not finally prevent, the balancing of international payments provided the country keeps ahead in creating unemployment and in reducing the standard of life. If the timing were adroit, and no one need accuse the Right in Europe of lack of tactical skill, it is probable that the attempt would lead not to bloody revolution but to a sullen apathy and the disintegration of the democratic Labour movements already hard pressed by the Communists. This has already happened in Italy. It is threatened in Germany and France. A few more years of this cure, and even the power of the Roman Church and the fear of the Dictatorship of the Communist Party will not retain the loyalty of the majority of the population for the Western social system. Those who are irked by the greater equality now established in Britain, by the difficulty of obtaining domestic service, by the pressure of taxes, should ponder over this before they continue their song of hate or even those tunes of coy reminiscence of the joys of high rates of interest and expensive false teeth.<sup>2</sup>

<sup>1</sup> Cf, for example, the recent policy declarations of the Conservative Party in Britain, of which Mr. Attlee could speak with full justification as the worst type of deception. Having declared themselves eager to lift controls and promised large-scale tax-relief, the authors of this document proceed to assure the nation that no cuts in social services are contemplated. As no measure is promised to achieve a substantial reorganization of industry and thus increase national income, the value of such specious promises can easily be gauged. It will take its place together with the Zinoviev Letter, the billion-mark notes and the promise to maintain the old party of the pound, the promise to uphold the League of Nations, Mr. Attlee's Gestapo, and the rest, in the museum of electoral tricks.

<sup>2</sup> This does not mean that abuses of the present social service schemes should not be investigated, but they must be investigated by people who are, in principle, favourable to their continuance.

Nor should the repercussions of these 'readjustments' on the large, under-developed areas be underestimated. What has already happened through the sharp cut in prices and incomes is quite sufficient to fan the discontent of the coloured populations of Africa and Asia, unless the trend is promptly reversed. Hence there is a danger of an increasing drain of military commitments in these areas instead of their contributing to the common recovery of the world economy. The consequent over-extension of European, indeed American, means can only lead to a crash and further enforced withdrawals which must in the end result in hysterical retaliation and a general conflagration.

It would be well not to disregard the menace.<sup>1</sup> Indeed, only if it is taken seriously can it be averted and an evolutionary, compromise solution found. Yet, despite all these negative indications, despite the fact that the Marshall Plan was carried, even though not launched, as an anti-Communist measure, there is some hope that the United States will not, once more, plunge itself and the rest of the West into chaos. Mr. Truman's inaugural address and his call in July 1949 might be interpreted as the beginning of better things to come. It is up to the British Government to crystallize public opinion in favour of a more enlightened approach.<sup>2</sup>

There is no immediate prospect for Britain of easy prosperity in any event. If the United States forsook the magnificent departure of Marshall Plan and reverts to the orthodox policy of restriction, if she did not make tariff concessions and remained subject to severe fluctuations, the immediate outlook becomes darker, even if Marshall Aid, as is likely, will be continued on its present basis until

<sup>1</sup> Significantly enough, one of the most conservative late members of Congress suggested that 'if we are not successful in Western Europe for any reason and should go into a depression we might make war to cover up our failure' (Mr. Tinkham quoted *New York Herald Tribune*, Paris, August 13, 1949). While such statements need not be taken tragically they shed some light on the general atmosphere, especially in Conservative circles. Equally significant is the converse tendency of certain *à-dévant* 'New Dealers' with progressive opinions on internal policy to be out-and-out fanatics of international *laissez-faire*, hoping somehow or other that the increase in sales abroad (presumably suppressing the fact that the limits are set by the actual amount of dollars at the disposal of foreigners) would decrease the need for internal deficit finance.

<sup>2</sup> One of the most disturbing features of the political campaign against the Government is that it might invite American intervention in the domestic policy of this country and thus lead to an irresistible exacerbation of Anglo-American relations. On the Continent such American invention has already led to a strengthening of the extreme Left (and the extreme Right), thus reducing the chances of a compromise solution. Should the U.S. economic position worsen, this intervention might easily lead to social strife and possibly to serious international complications.

1952. If Western Europe for a time repudiates the lessons of a common experience, the problems of each single country will be the greater. The regional area for which long-term planning can effectively be carried will be smaller with greater loss of efficiency.<sup>1</sup> But even if alone, even if unaided, Britain can and must try to uphold the principle that political freedom and democracy can only survive if economic equity and equal opportunity are fairly safeguarded. For a time life might be difficult. But it will not take long for her example to show that it is her policy which safeguards the Western concept of human decency, and she will then no longer need to carry an undue proportion of the burden of social progress.

<sup>1</sup> On the arrangements needed cf. above



## APPENDICES

### I

## THE PROPOSALS FOR POST-WAR INTERNATIONAL CURRENCY AND INVESTMENT<sup>1</sup>

### I. THE PRIORITY OF MONEY

AS the first of a series of international agreements to restore the shattered world economic system and create conditions in which it can prosper without a periodic recurrence of grave crises such as was experienced between 1929 and 1933, the Final Act of the United Nations Monetary and Financial Conference<sup>2</sup> merits closest attention. The task of analysing the proposals is in any case difficult because of the complexity of the problems dealt with. It has, like some of its predecessors, not been made easier by the method of presentation chosen. The world has been given the statutes of two international institutions drawn up in legal style which is unfamiliar to most. The implications of the complicated rules are, therefore, extremely difficult to grasp, and have at least on one point eluded the drafting experts themselves!<sup>3</sup>

The Conference was, moreover, severely limited in scope to monetary and financial problems. In its resolutions it emphasizes the fact that an ordered post-war world cannot be 'completely attained through the instrumentality of the fund alone.' It recommends, therefore, that further agreements should be negotiated on commercial policy, on the orderly marketing of staple commodities, on the special problems arising out of economic demobilization, and, last, but let us hope not least, on the maintenance of 'high' levels of employment.

It would, therefore, be unfair to criticize the Conference for failing to accomplish what has *a priori* been excluded from the scope of its deliberations. Yet legitimate doubts might arise whether the instruments establishing an international monetary fund and a bank

<sup>1</sup> Written in collaboration with Mr E. F. Schumacher for the Parliamentary Monetary Policy Committee, August, 1944.

<sup>2</sup> Bretton Woods, New Hampshire, U.S.A., July 1-22, Cmd. 6546, presented by the Chancellor of the Exchequer to Parliament by command of His Majesty, August, 1944.

<sup>3</sup> Cf. below, Article VIII, Section 2 and Section 4 b.V.

of reconstruction and development, the acceptance of which was recommended by the experts assembled at the Conference to their respective governments, can safely be ratified by the different countries before more definite knowledge can be obtained of the intentions of at least the more important of the governments represented at Bretton Woods on those other vital problems. A monetary scheme could by itself only be ratified if it were so framed that it would by itself enable the government of every single one of the participating countries to pursue a full employment policy irrespective of the attitude of other governments. This, as we shall try to show below, the Bretton Woods instruments have signally failed to achieve.

Indeed, there are good reasons for which it may be regretted, from a European point of view, that the governments of the United Nations made a beginning, so far as post-war international arrangements on the economic field were concerned, with monetary and financial matters instead of coming to an agreement about certain urgent tasks of reconstruction.

Lord Keynes<sup>1</sup> argued that he saw 'no particular reason why the understanding of the monetary scheme would be assisted by further knowledge on the other matters. In fact, if we are less successful than we hope for in other directions, monetary proposals, instead of being less necessary, will be all the more necessary.' It is quite true, as Lord Keynes said, that 'tariffs and depreciations are in many cases alternatives.' This would have been a good reason to arrange the talks *concomitantly*. But to give the monetary problem a priority in time cannot be supported for 'logical reasons.' It is evident that the monetary talks have been accorded this priority because no American administration in a presidential election year could participate in an international conference on commercial policy. The American Government, possessed with a vast liquid reserve, and on the basis of an economic position which seems to foreshadow continuous export surpluses, cannot offer many concessions on the monetary terrain. It cannot have any wish to depreciate the dollar, nor does it wish to control the export of capital. It can only ask for concessions without being able to offer any *quid pro quo*.<sup>2</sup>

<sup>1</sup> House of Lords, May 16, 1944, Col 778

<sup>2</sup> The comparison, in subsequent pages, between the Clearing Union Plan and the present proposals show the far-reaching changes which have been introduced since the first idea of an International Currency Agreement was mooted. All these changes were in what one may describe the 'orthodox' direction

In the matter of commercial policy, on the other hand, America would indeed be able to offer concessions which can logically be weighed against any undertakings by other countries to forego the obvious advantages which certain monetary means offer to debtor countries and countries which are in danger of developing import surpluses. Only *simultaneous* agreements, elaborated with due consideration of the effects of each of the agreements on the problems dealt with in the others, will have a good chance of successful working, i.e. enable the maintenance of full employment which is the declared aim of British Government policy, and at the same time secure that it can be maintained under such circumstances that concessions in one field are duly acknowledged by counter-concessions in others.

## 2. FULL EMPLOYMENT AND THE EQUILIBRIUM OF BALANCE OF PAYMENTS

(a) *The Quantitative Factor.* The Final Act of the Conference substantially repeats the Statement of the purpose which has been outlined in the Joint Statement.<sup>1</sup> In earlier contributions<sup>2</sup> we have discussed the importance of the quantitative factor in judging the value of an international currency scheme. The Final Act, by fixing the total amount of quotas at \$10,000 million, constitutes a further slight improvement on the Joint Statement which itself marked some progress as contrasted with the original White Plan. Nevertheless, even this improvement leaves the Fund substantially below the original British 'Proposals for the Establishment of a Clearing Union' which not merely fixed the total reserves *additionally* created at a far higher figure—\$21,172 million—but made the *whole* of these reserves (except, of course, those of the creditor country itself) available for payment to any of the member countries. The present proposal accepting the constitution outlined in the White Scheme still suffers from a double limitation criticized in our earlier memoranda.<sup>3</sup> In other words, Great Britain on the basis of the quotas outlined in Schedule 'A' can draw upon the Fund to a maximum

<sup>1</sup> Cmd. 6519

<sup>2</sup> Institute of Statistics, Oxford, Bulletin Vol. 5, Supplement No. 5. 'New Plans for International Trade,' T. Balogh, 'New Plans for an International Investment Board,' *ibid*, p. 254, and 'International Monetary Fund,' by E. F. Schumacher and T. Balogh, *ibid*, Vol. 6, p. 81.

<sup>3</sup> Cf. 'New Plans,' *op. cit.* pp. 18–20, and Schumacher-Balogh, pp. 84–7.

of \$325 million per annum for four years, provided that the American contribution of \$2,750 million has not previously been exhausted by other member countries' requirements to cover deficits in their balance of payments towards the U.S.<sup>1</sup>

It cannot be pretended that the amount of additional liquidity thus provided could possibly be regarded as sufficient 'to give confidence to members by making the Funds' resources available to them under adequate safeguards, thus providing them with opportunity to correct maladjustments in their balance of payments without resorting to measures destructive of national or international prosperity.'<sup>2</sup> The fluctuations in the American effective demand for foreign products between years of prosperity and depression varied by a multiple of \$687.5 million (corresponding to 25 per cent of the U.S. quota). Past experience, moreover, is not conclusive, as full employment was not maintained abroad when America was suffering from depression, and if the attempt were to be made to do so, the American export surplus would increase faster than in past periods under the impact of the high effective demand abroad absorbing more of the potential exports from America.

The estimates published by Dr. Goldenweiser<sup>3</sup> on prospective post-war full employment national income in the U.S. provide very timely reading in this respect. Even under the favourable assumptions which he made,<sup>4</sup> not less than \$27,000 million of private investment or *export surplus* would be needed *per annum* to absorb savings. It is this figure which has to be compared with the U.S. quota of \$2,750 million for *four years* or \$687.5 million p.a.<sup>5</sup> On the

<sup>1</sup> Proposals for an International Clearing Union, Cmd. 9437, Section 1, para 1 (c) expressly stated, 'We need a *quantum* of international currency, which is neither determined in an unpredictable and irrelevant manner, as, for example, by the technical progress of the gold industry, nor subject to large variations depending on the gold reserve policies of individual countries, but is governed by the actual current requirements of world commerce, and is also capable of deliberate expansion and contraction to offset deflationary and inflationary tendencies in effective world demand.' It cannot conceivably be claimed that the quotas established, Annex A, fulfil these requirements, especially as the use of the resources of the Fund is subject to penal charges.

<sup>2</sup> Final Act, op. cit., p. 16, Article I, Purposes.

<sup>3</sup> Federal Reserve Bulletin, May, 1944.

<sup>4</sup> He assumes that unemployment will continue at the level of 2,000,000, that the ratio of working to total women will not increase, that productivity per head will have increased during the war 10 per cent only, but that government expenditure will continue after the war at the level of \$30 billion.

<sup>5</sup> Cf. proposals for an International Clearing Union, Cmd. 6437, op. cit., Article IV, para. 15 'The facilities offered will be of particular importance in the transitional period after the war, as soon as the initial shortages of supply have been overcome. Many countries

other hand, looking at the post-war balance of payments problem of Britain, Lord Keynes announced that the undischarged floating war debt of Britain mainly in the form of sterling balances will amount at the end of 1944 to \$12,000 million. It may be objected that that matter is not to be dealt with by the International Monetary Fund. As we shall see, the problem whether those sterling balances can be left *unfunded* within the sterling area, or have to be dealt with by funding operations, is very germane to the chances of solving the current balance of payments problems successfully.<sup>1</sup>

The prohibition of discriminatory methods for the balancing of international payments, whether multilateral or bilateral, *ceteris paribus*, increases the size of the balances arising out of these payments, unless full agreement is reached, not merely on full employment policy but also on a deliberate variation of the degree of protection in each of the member countries, so as to permit the achievement of a balance in international payments without deflation (i.e. in the case of certain creditor countries this can only happen by the creation of over-full employment).

(b) *Devaluation*. The quantitative aspects of the scheme thus do not provide sufficient additional liquid reserves to deal with balances arising out of an attempt to maintain full employment in some countries when others are depressed. The proposals envisage (Article IV, Section 5) a change in the gold value of the currency as a means 'to correct fundamental disequilibrium.' The Fund cannot raise any exception to changes of 10 per cent or less of the initial value of the currency as determined under Article XX, Section 4, of the Agreement.<sup>2</sup> If the proposed change of the par value together with all previous changes does not exceed a further 10 per cent of the initial par value, the Fund must agree or object within 72 hours after the members' request. For more substantial changes (all prior

will find it a difficulty in paying for their imports and will need time and resources before they can establish a readjustment. The efforts of each of these debtor countries to preserve its own equilibrium by forcing its exports and by cutting of imports which are not strictly necessary, will aggravate the problems of all the others.' How is this to be reconciled with the present statement, which expressly excludes all post-war problems from the purview of the Fund?

<sup>1</sup> Except on the basis of Article V/4. Cf. below, especially Section 3b

<sup>2</sup> i.e. except for countries occupied by the enemy 'while the territory is a theatre of major hostilities or for such period thereafter as the Fund may determine the value ruling 60 days prior to the entry into force of the Agreement' Unless a special agreement is made by the Fund with a member apparently by majority vote, this ruling exchange value is adopted as the initial par value of the currency.

changes must be counted) the Fund is given a longer time to declare its attitude.

The Agreement thus restores fixed exchange rates at the level ruling (as it appears by implication from Section 4j) some time between March 1, 1945, and November 1, 1945, i.e. presumably within a year of the end of the hostilities with Germany. It requires a great faith in the omniscience of the experts to assume that 'correct' par value can be fixed on this basis, especially as the wartime rates of exchange are wholly irrelevant to peace requirements on account of the operation of mutual aid on the one hand, and the particular character of wartime expenditure of governments abroad on the other. It will, moreover, depend on the terms of the monetary agreement, commercial policy, etc., as well as the future role of the government or government-controlled agencies in foreign trade, what level of the exchange can be considered as 'satisfactory.' The permission to exchange the value by 10 per cent does not safeguard countries faced with acute problems in their international balance of payments.

It has been provided by Article IV, Section 5f, that the Fund shall concur in a proposed change 'if it is satisfied that the change is necessary to correct a fundamental disequilibrium.' 'In particular, provided it is so satisfied, it shall not object to a proposed change because of the domestic, social, or political policies of the member proposing the change.' This safeguard, contrary to superficial impression, is only of a limited value. It depends entirely on the interpretation of the expression 'fundamental disequilibrium.' Deficits in the balance of payments may arise out of two basically different causes. They may arise firstly because the long-term trend of efficiency money wages in one country differs from that of another country, while both are fully employed.<sup>1</sup> This particular type of disequilibrium which might be called 'the classical case' may indeed be susceptible to the curative method proposed.

There is, however, a different type of disequilibrium of much greater quantitative importance in modern times. It is due to the loss of balance in one country. Disequilibria of this character, due to cyclical causes, are not likely to be cured by devaluation.<sup>2</sup> An

<sup>1</sup> Or a change in long-run demand or supply conditions which may result in a permanent change in the terms of trade.

<sup>2</sup> Cf. Schumacher-Balogh, *op. cit.*, and *The Economics of Full Employment*, Institute of Statistics, Oxford, Part V.

attempt to do so would in all probability violently turn the terms of trade against a devaluing country, without increasing foreign demand for its products. It is unlikely that this latter case has been envisaged by the experts.

(c) *Rationing of scarce currencies.* Following Mrs. Robinson<sup>1</sup> high hopes have been attached to the proposal of 'rationing scarce currencies.' This proposal, which originally was made in the White Scheme, and then was taken over by the Joint Statement, recurs in the Final Act (Article VII), though in a somewhat weaker form. Lord Keynes attributed<sup>2</sup> the highest importance to this provision, as he thought that a creditor country, rather than expose itself to a discriminating restriction on its exports, would be prepared to provide the Fund with additional resources in terms of the scarce currency by lending.

Even if the creditor were to do this the second limiting factor, i.e. the insufficiency of the debtor quotas, would still make this scheme inadequate to permit single countries to maintain full employment unless the limits on borrowing imposed by the quota regulations were to be waived, which is unlikely.<sup>3</sup> In any case, a discriminating curtailment of *exports* from the export surplus country whose currency had become scarce would itself pose awkward problems. The development of alternative sources of supply could not be undertaken in the short run, especially if full employment was the declared policy in the majority of member countries, and general excess capacity and unemployment was rare. The imposition of rationing of scarce currencies is, therefore, in itself a restrictive method of readjustment, and not one which is in accord with the aim of maintaining full employment in the world economic system. Together with the insufficiency of the quota of potential debtor nations relative to the U.S. quota, this makes the clause of more limited value than either Mrs. Robinson or Lord Keynes suggested.

Such value, however, which it may have possessed in bringing some, however slight, pressure to bear upon potential creditor countries has been removed from the Final Act. Not only can

<sup>1</sup> Mrs Joan Robinson, *Economic Journal*, 1943

<sup>2</sup> House of Lords, May 23, Col. 842.

<sup>3</sup> Especially as the Agreement provides that the waiver of conditions should take place only 'on terms which safeguard its [the Fund's] interests' and 'especially in the case of members with a record of avoiding large or continuous use of the Fund's resources' This definition 'of deserving debtors' is a somewhat odd application of private deposit banking considerations to matters of international economic policy purported to aim at stabilizing full employment

debtor countries not impose restrictions before the reserves of the potential scarce currency are exhausted so as to minimize the eventual shock exerted by the sudden cessation of exports from the potential scarce currency country, but even during the scarcity period restriction 'shall be no more restrictive than is necessary to limit the demand for the scarce currency to the supply held by, or accruing to, the member in question; and they shall be relaxed and removed as rapidly as conditions permit.'<sup>1</sup> Under these circumstances the value of the clause in helping member countries to maintain full employment demand at home cannot be regarded as significant.<sup>2</sup>

One further point should be added—as long as the U.S. are willing to purchase further capital assets in the debtor country (e.g. the British Commonwealth), and thus provide the Fund with dollars, the scarce currencies' rationing clause cannot be invoked. The inevitable smash of the scheme may thus be postponed until after the debtor countries have alienated the most important of their assets and thus have given up the essential basis on which their economic system and their standard of life was built up. Article IX, if stringently interpreted, will prevent any counter-measure in this respect under the pain of expulsion from the Fund.

(d) *Enforcing deflation.* Even this slight pressure on potential creditor countries, however, seems to have been regarded as excessive by the representative of the potential creditor countries. The Final Act, therefore, provides that persistent debtors of the Fund should be penalized according to the following Table, the rate of charges increasing both according to the length and the level of the borrowing in terms of percentages of the quotas.

Steeply increasing charges are operative, however small the extent to which a country has been using the Fund.<sup>3</sup> This means that the Fund can only be used in practice for *seasonal* movements in the balance of payments, and every country will make desperate efforts to repay the foreign currencies they may have bought from the Fund. This is a somewhat odd application of the 'principles' of

<sup>1</sup> Article VII/3/b.

<sup>2</sup> Cf. Joint Statement, op. cit., Explanatory Notes, para. 9. 'It was a feature of the Clearing Union proposals that they introduced certain provisions for placing on creditor countries as well as on debtor countries some pressure to share the responsibility in appropriate circumstances for maintaining a reasonable stability in the balances of international payments. These have been replaced in the new proposal by a different, but perhaps more far-reaching, provision with the same object in view.'

<sup>3</sup> The use of the Fund by a debtor country results in (and is measured by) the increase of the Fund's holding of the debtor's currency above its quota.



deposit banking to international economic relations, supposedly aimed at maintaining full employment. The Fund is effectively 'protected' against calls on it.

RATE OF CHARGES PER CENT P.A. ON BORROWING FROM THE FUND

Fraction of quota of excess holdings	Length of Borrowing	3 mths.	9 mths.	1-2	2-3	3-4	4-5 years	5-6	6-7	7-8
up to 25 %		—	$\frac{1}{2}$	1	$1\frac{1}{2}$	2	$2\frac{1}{2}$	3	$3\frac{1}{2}$	4
25-50 %				$1\frac{1}{2}$	2	$2\frac{1}{2}$	3	$3\frac{1}{2}$	4	$4\frac{1}{2}$
50-75 %				$2\frac{1}{2}$	$2\frac{1}{2}$	3	$3\frac{1}{2}$	4	$4\frac{1}{2}$	$5\frac{1}{2}$
75-100 %				$2\frac{1}{2}$ <sup>1</sup>	$3\frac{1}{2}$	$3\frac{1}{2}$	4	$4\frac{1}{2}$	$5\frac{1}{2}$	?
100-125 % <sup>1</sup>				3	$3\frac{1}{2}$	4	$4\frac{1}{2}$	$5\frac{1}{2}$	?	?
125-150 % <sup>1</sup>				$3\frac{1}{2}$	4	$4\frac{1}{2}$	$5\frac{1}{2}$	?	?	?

The deflationary bias characteristic of the gold standard—so eloquently criticized by Lord Keynes in the original Clearing Union Proposals<sup>2</sup>—has been restored with vengeance. The rates of charges are such that it would be certainly more favourable to undertake borrowing from existing private institutions. Lord Keynes in his defence of the Joint Proposal<sup>3</sup> commended the scheme because it provided 'a large addition to the world stock monetary reserves, distributed, moreover, in a reasonable way.' The present scheme cannot be held to provide additional monetary reserves; it provides at best an insufficient amount of short-term credit facilities, on

<sup>1</sup> Under Article VII/4.

<sup>2</sup> Cmd 6437, op cit, Section V, paras. 10-11. 'The Clearing Union Plan aims at the substitution of an expansionist, in place of a contractionist, pressure on world trade. It affects this by allowing to each member State overdraft facilities of a defined amount. Thus each country is allowed a certain margin of resources and a certain interval of time within which to effect a balance in its economic relations with the rest of the world. These facilities are made possible by the constitution of the system itself and do not involve particular indebtedness between one member State and another. A country is in credit or debit with the Clearing Union as a whole. This means that the overdraft facilities, whilst a relief to some, are not a real burden to others. For the accumulation of a credit balance with the Clearing Union would resemble the importation of gold in signifying that the country holding it is abstaining voluntarily from the immediate use of purchasing power. But it would not involve, as would the importation of gold, the withdrawal of this purchasing power from circulation or the exercise of a deflationary and contractionist pressure on the whole world, including in the end the creditor country itself. Under the proposed plan, therefore, no country suffers injury (but on the contrary) by the fact that the command over resources, which it does not itself choose to employ for the time being, is not withdrawn from use. The accumulation of Bancor credit does not curtail in the least its capacity or inducement either to produce or to consume.' Can it possibly be claimed that the present provisions which protect the Fund against 'excessive' use fulfil these claims?

<sup>3</sup> House of Lords, May 23, 1944.

prohibitively expensive terms. The deflationary bias of the scheme has been further increased by the provision (contrary to the original British proposals) that creditor countries should not merely not be penalized, but derive a benefit from the lack of success of their domestic policy which resulted in their accumulating a chronic surplus. Not only are they to receive a 2 per cent non-cumulative payment on the amount of their currency which has been used by the Fund,<sup>1</sup> but what is certainly more important, on questions affecting the waiver of conditions ( $V/4$ ), and the penalizing of members by making them ineligible for using the Fund ( $V/5$ ), the persistent creditor receives additional votes, while the debtor is penalized by having its votes reduced. A clearer proof of deflationary bias does not seem to be required. It is a far cry from the original British proposals.

(e) *Conclusions.* Having muddled the problem of long- and short-term disequilibrium in the balances of payment of member countries, disregarding the latter, and more important case almost completely; having devised a method—devaluation—which might conceivably be effective for the former, but certainly will not work in the latter case, the experts have devised a *mechanism*—the Fund—which *will clearly enforce deflation in all countries whenever there is deflation in any of the more important members.* Unless, therefore, all members by themselves not merely maintain full employment, but also manage their foreign economic relations so as to keep their international effective demand stable (i.e. in the ways indicated in the British Clearing Union Proposals, by surplus countries decreasing their tariffs and other protective measures), the acceptance of the scheme can only have two results. It will:

- (i) either lead to a perpetuation of international business cycles, or
- (ii) lead to a promiscuous national autarchy, as potential deficit countries must restrict imports from *all* countries in order to maintain their balance of payments with the potential creditor country which has lost its equilibrium. A more unfortunate way of implementing the purported purpose of the Fund 'to promote International Monetary Co-operation,' 'to facilitate the expansion and

<sup>1</sup> Article XII/6/b 'If any distribution is made, there shall first be distributed a 2 per cent non-cumulative payment to each member on the amount by which 75 per cent of its quota exceeded the Fund's average holdings of its currency during that year. The balance shall be paid to all members in proportion to their quotas. Payments to each member shall be made in its own currency.'

balanced growth of international trade,' and 'to contribute thereby to the promotion and maintenance of high levels of employment and real income' can hardly be imagined.

### 3. THE MONETARY PLAN AND REGIONAL ARRANGEMENT

(a). *The implications of non-discrimination.* Even more damaging would be the consequences of the Bretton Woods proposals so far as the establishment of regional arrangements between countries having special ties of an economic or political character is concerned. The implications for the sterling block, and more especially for a reorganization of the European economic structure on rational lines, are incalculable. Lord Keynes has argued that 'for a great commercial nation, like ourselves, this [the general interconvertibility of currencies] is indispensable for full prosperity.'<sup>1</sup> The relevance of this dictum on Britain's Commercial Policy has been analysed in a preceding memorandum. It was found that such multilateral character as British international relation may have after the war will depend entirely on *U.S. commercial policy*; and that, unless *U.S. commercial policy* changes fundamentally as compared with pre-war, Britain has everything to gain by negotiating reciprocal purchase agreements with its suppliers of foodstuffs and raw materials. It has been emphasized that the reason for rejecting the principle of non-discrimination in monetary affairs is not the desire to introduce multiple exchange rates, or to drive hard bargains. Except for a small group of interested parties, the critics of the plan have the opposite aim in view. What they want is to be able to offer stable and expanding markets at favourable prices to countries which have a complementary rather than a competitive economic system. Without knowing that exports will be practicable to pay for imports, imports must be restricted.

Britain, if full employment is maintained here, will be a good market to sell in; she will not, especially if other countries became depressed, necessarily be a good market to buy in. Hence an uneasy position will result, in which full employment policies will prove difficult. A devaluation of sterling under these circumstances, and for reasons explained in our earlier article, does not seem an adequate safeguard. It will, for instance, if some of the sterling area countries

<sup>1</sup> Lord Keynes, House of Lords, May 23, 1944, Col. 840.

are not suffering from a deficiency in the balance of payments (partly because of the deficiency of Britain herself), hardly be possible to devalue all the currencies of the sterling area together. If our suppliers, at the moment when Britain is forced into devaluation, are not forced to follow suit, the devaluation of sterling may not only not improve, but might worsen, the situation of Britain—unless full employment policy is given up, and thus the price elasticity of demand for imports increased.

It must, moreover, not be left out of account that the theory underlying the plan tacitly assumes that countries of about equal importance face each other; or rather, that trade is not conducted by countries but by individual traders, and that therefore the fact that countries are of unequal size and importance is irrelevant from the point of view of a monetary agreement. This theory cannot be sustained. The internal market of the United States is so vast, the factors within America in favour of American firms so important that, on the basis of that market, mass production methods can be introduced which are unavailable to entrepreneurs in smaller economic areas. If, therefore, reciprocal trade agreements embodying definite planning of production are not permissible, areas smaller than America are definitely handicapped. It may be objected, and Lord Keynes (*Hansard*, May 23, Col. 870) holds this view (cf. also his letter to *The Times* of August 25, 1944, immediately contradicted by an American correspondent on August 28, 1944), that a *voluntary agreement* for reciprocal transactions by two countries will be permissible. But it is most doubtful whether this interpretation can be reconciled with the American conception of discrimination, unless, indeed, the two countries making the agreement have a complete and direct control over foreign economic relations, i.e. the foreign trade and payments monopoly. The discussions which centred round the Soviet economic non-aggression clause submitted to the League of Nations in the early 1930's has shown that the United States viewed government purchases with great disfavour, and was unwilling to enter into any definition of 'legitimate' government trading which would link purchase with sales. If, moreover, a country retains an individualistic economic system, it is not the State but *individual traders* who export and import; and it is not those traders who export who also are in charge of imports. Therefore, it will be difficult, unless direct barter agreements are entered into,

to force members in a primary producing country to buy from the country to which the primary producing country has exported an equivalent amount of manufactures, if the purchasing country is not as cheap a market as a third country to which, however, sales are impracticable.

When Lord Keynes said<sup>1</sup> that the expansion of British export industries would be much easier if obstacles to trade could be diminished or done away with, he enunciated a truism. It is not suggested, however, that tariffs are to be substantially reduced or done away with, or that effective demand in the countries with which Britain is trading will be maintained. Hence the imports can only be secured by effectively procuring automatic finance for them. This is automatically achieved by reciprocal purchase and payments agreements. The principle of monetary non-discrimination which, unless the U.S. interpretation is expressly modified, outlaws voluntary payment agreements, not only amounts to an obligation to abide by the unrestricted interplay of market prices—however much they are a result of a loss of equilibrium—but also to a unilateral acceptance of the bargaining power inherent in export surpluses, i.e. in foreign loans, while renouncing the bargaining power in the capacity of being able to provide favourable and steady markets.

The Agreement proposed, unless the present meaning of the terms used is reinterpreted in a revolutionary fashion, is therefore prejudicial to all long-term planning, except if a country institutes *full government monopoly* over foreign trade and payments. No mixed system could abide by these agreements and institute planning. By accepting, moreover, the false thesis applicable only to conditions of perfect competition with perfect foresight that the size of national units is unimportant from the point of view of foreign economic policy, the agreements prejudice the bargaining position of the smaller countries which, if they have to bargain with America singly, i.e. bilaterally (as was indeed the case in the negotiation concerning the so-called Cordell Hull Reciprocal Trade Agreements), are at the mercy of America.

The basic fallacy of Lord Keynes' attitude is that he contrasts a situation of being able to export and use the proceeds of the exports to buy anywhere, with the position of exporting and not being able

<sup>1</sup> *ibid.*

to purchase except in the country to which the export was directed. This amounts, however, to the implicit assumption that effective demand is maintained in the system as a whole. If it is not so maintained, the true alternative would be between being able to export though restricted in the use of the proceeds to purchases in the buying country, or not being able to export the same extent. A reciprocal purchase or clearing agreement puts the onus of the reciprocal transaction on the seller. Thus it creates conditions in favour of the original purchaser; and if the purchaser pursues a full employment policy this fact imparts an expansionist bias to the whole system. Such reciprocal agreements therefore provide the effective means by which the balance of international payment can be maintained irrespective of the state of trade abroad.<sup>1</sup> They lead to the organization of regional units which pursue common planning in their economic development. The alternative is narrow national autarchy.

(b) *The Sterling Block.* Apart from these generally unfavourable consequences of the envisaged restoration of the general convertibility of currencies, without due safeguards, the proposed agreement has an equally destructive implication on the specific problem of the maintenance of the sterling area. In the explanatory notes to the Joint Statement<sup>2</sup> the U.K. experts stated, 'Nor is the scheme intended, when the obligation of free convertibility has been accepted, to interfere with the *traditional* [our italics] ties and other arrangements between the members of the sterling area and London.' It has been pointed out that this reassurance meant little if anything. 'Traditionally' Britain was the world's largest creditor nation with

<sup>1</sup> Barter agreements, of course, might accomplish the same task but they are clumsy, and as the range of choice is very much reduced they will be liable to exploitative pressures even more than clearing agreements. Given, however, the restricted initiative on the part of most British Government departments, it is almost impossible to visualize that extended use will be made of such direct bulk barter, whilst it is possible to visualize bulk purchases, provided the countervailing exports are left to the individual British exporters and clearing country importer. In practice, therefore, the reassurance given by Lord Keynes in his second speech and in his intervention explaining his position to Lord Balfour, is unsatisfactory. It is the more unsatisfactory as multilateralism does not prevent the restrictive increase of the prices of British imports (e.g. the wheat agreement). It merely confers a one-sided advantage on primary producers and export surplus countries. (As we now know the British Government at the time of Lord Keynes' speech not only consented to proposals outlawing such agreements but itself put forward proposals to that effect. While Lord Keynes strenuously opposed them he must have had cognisance of them. Incidentally the episode throws a peculiar light on fashionable efforts, to suggest that Lord Keynes returned to 'free' trade views.)

<sup>2</sup> Joint Statement, Cmd 6519, op cit 1, Explanatory Notes by United Kingdom experts on the proposal for an International Monetary Fund, p 5, para 11.

its short-term obligations covered (except for a period after 1925) by ample reserves of gold and liquid assets abroad. According to Lord Keynes' statement, the undischarged floating foreign debt of this country after the war will amount to £3,000 million by the end of this year and may rise towards £4,000 million before the hostilities come to an end, unless satisfactory agreement can be reached on the continuation of Lend-Lease and on the finance of British war expenditure of the Middle East and the Far East.

The cumulative effect of the provisions of the agreement is not merely to end the present arrangement maintaining the sterling area, but also to put an intolerable strain on the British balance of payments.

- (i) VI/1 prohibits the member from using the Fund 'to meet a large or sustained outflow of capital.'
- (ii) VIII/3 prohibits discriminatory currency arrangements except for the transition period (cf. below).
- (iii) VIII/4/a provides that while *currently* accruing balances can be used for purposes of *capital export*, *old* balances can be used for making payments for *current* transactions elsewhere.

This means that where there are in a country *old* balances, these can be *indirectly* exported, i.e. they enforce total blocking if sufficient reserves are not available. VIII/4/b/v, which permits the refusal of conversion wherever a country has no access to the Fund, does not provide a satisfactory solution because it also enforces the total blocking of the balances. How can international banking be conducted under the threat of *complete* blocking? This article, moreover, conflicts with Article VIII/2/a and 3, which prohibit discriminatory currency practices and the blocking of 'current' payments.

Thus the proposed Agreement, far from restoring the general convertibility of sterling, will result, after a transition period of dubious length (cf. below), in *curtailing the existing convertibility* of sterling within the sterling area. That this would end the sterling area as we now know it is not open to doubt. Lord Keynes in a letter to *The Times*<sup>1</sup> argued that the proposed arrangement does not add or detract from the capital export capacity of member countries. This argument completely misses the point. As long as sterling countries are able to use their sterling reserves in London *for all*

<sup>1</sup> May 20, 1944.

*purposes including capital payments, within the sterling area*, those sterling balances can be regarded by their owners as true international reserves. Yet, as far as Britain is concerned, as long as they are only used for *intra-sterling block payments*, they remain in London. Only for payments *outside* the sterling area can they not be used, as long as the scarcity of outside foreign exchange resources continues in the sterling area *as a whole*. Payments outside the sterling area are, and would continue to be, rationed for *all* members, with common consent, according to the urgency of the need, and with due regard to the possibility of substituting 'sterling area' supplies for outside products. The dearth of foreign currencies logically leads to a *closer and more positive* conception of the purpose and functions of the sterling area. If, however, non-discriminatory treatment is to be accorded to *all countries*, exchange control must be introduced also with respect to *intra-sterling block payments*. The specific purpose which these balances play in the monetary structure of those of Britain's creditors, which are at the same time members of the sterling block, is completely altered.

This seeming paradox is exactly similar to the position of the deposit banking system in a modern monetary structure. As long as its solvency is undoubted, no one will 'run on it' and cash is not normally needed. As soon as doubts arise, sufficient cash cannot be provided. *The prohibition of 'limited convertibility' within the sterling block* will necessitate the total blocking of these balances, a truly Schachtian device, which the advocates of the scheme so abhor. Whether under those conditions the rise of a 'black market' and multiple exchanges can be avoided is most questionable. The proposed agreements, by disregarding the specially intimate character of economic monetary and financial relationship within the Commonwealth and other members of the sterling area, enforce complete blocking of all existing sterling balances. If, however, these balances must be completely blocked, a higher rate of interest must be paid on them. The importance of this on the *current* balance of payment can easily be illustrated. The sterling area countries will need (partly because of the wartime inflation of their currencies) about £1,000 million as working balances and currency reserves in London. Should Britain's wartime debt be eventually reduced to this figure, no further repayments need be contemplated. British reserves would no longer be menaced by the threat of withdrawal



of such balances. Should the war in Japan continue until the end of, say, 1945, and the wartime expenditure not be amenable for other reasons to a considerable reduction, Britain would have to contemplate the repayment of £3,000 million. If the period of amortization is 25 years, and no interest has to be provided, a yearly payment of £120 million will suffice. At the rate of interest of 1 per cent the burden rises to £130.2 million: at 3 per cent, which has to be contemplated if the balances were blocked, however, to not less than £172.3 million.

#### 4. THE TRANSITIONAL PERIOD AND THE INTERPRETATION OF TERMS

Lord Keynes<sup>1</sup> stated that 'it was clearly recognized and agreed that during the post-war transitional period of uncertain duration, we were entitled to retain any of those wartime restrictions and special arrangements with the sterling area and others which were helpful to us.' The British experts emphasized the fact that<sup>2</sup> 'a member is entitled to use its own judgement as to when it is strong enough to undertake the free convertibility of its currency which it has accepted as the desirable aim. The drafting of this clause, as the experts on both sides understand it, allows, during the transition period, the maintenance and adaptation by the members of the sterling area of the arrangements now in force between them.' Suddenly, and without further warning, Article XIV/4 provides that the Fund (true enough 'in exceptional circumstances,' whatever that may mean) may demand after 5 years the withdrawal of exchange restrictions, and if they are not so withdrawn may declare the member ineligible to use the resources of the Fund under Article XV/2/a.<sup>3</sup> The constitution of the Fund is such as to make potential creditor countries dominant. The views of the creditors will, however, be influenced by different considerations than those of the debtors, and this sudden alteration represents a concession to the *laissez-faire* creditor point of view of the utmost importance.

Nor is this all. Article XIV/2 provides, 'Members shall, however, have continuous regard in their foreign exchange policies to the purposes of the Fund; and, as soon as conditions permit, they shall take all possible measures to develop such commercial and financial

<sup>1</sup> House of Lords, May 23, 1944.

<sup>2</sup> Cmd 6519, op cit, p. 5, *ibid*.

<sup>3</sup> It is not quite certain whether subsequently Article XV/2/b cannot also be invoked, and the offending member expelled.

arrangements with other members as will facilitate international payments and the maintenance of exchange stability. In particular, members shall withdraw restrictions maintained or imposed under this section as soon as they are satisfied that they will be able, in the absence of such restrictions, to settle their balance of payments in a manner which will not unduly encumber their access to the resources of the Fund.' Strictly interpreted, this paragraph provides that countries must steadily implement policies which facilitate the *restoration of unrestricted payments*, even at the cost of causing unemployment.

There is no doubt, moreover, that it is precisely in the so-called transition period that demand for foodstuffs and raw materials will tend to outrun supplies. Bilateral agreements will therefore be expected to be least helpful or even feasible to a manufacturing country such as Britain. As the supply of primary products will rise, the bargaining position of Great Britain is likely to improve. The retention of the power of negotiating *long-term* reciprocal purchase agreements offering stable and expanding markets at favourable prices to countries which have a complementary rather than a competitive economic structure is, therefore, of the utmost importance for Britain. Only by being able to give the assurance of such *long-term* favourable outlets in Great Britain can the suppliers of raw materials and foodstuffs be persuaded to forgo temporary gains in the critical period of shortage immediately after the war for long-term advantages. The outlawing of such reciprocal long-term agreements after a short transitional period will therefore severely handicap this country in the immediate post-war period, and render the solution of its short-run balance of payment problem impossible except by methods of restricting imports and increasing national autarchy.<sup>1</sup>

<sup>1</sup> Cf p 212 and note 1, p 214 Reciprocal agreements tend to decrease the balances arising out of foreign trade between countries. They provide, so to speak, an automatic finance for foreign trade and impart an expansionist bias to the system. Thus the outlawing of such agreements, other things being equal, increases the need for the creation of additional reserves. Hence the two main features of the new plan, the limitation of the Fund and the outlawing of discrimination, are mutually incompatible. If the second was accepted, effort should have been made to obtain U.S. consent to the creation of an International Central Bank of unlimited power of credit creation. But a clause prohibiting reciprocal transactions was embodied in the trade treaties negotiated by Mr Hull, and efforts to secure American agreement to a definition of legitimate government trading, linking purchases with sales, were completely unsuccessful. Article VII of the Mutual Aid Agreement with the U.S. lends itself to the interpretation that it outlawed all bulk purchases. If inadequate international agreements prevent Britain from obtaining reasonable terms of trade, most of the readjustment in her

The interpretation of this and any other points of the agreement according to Article XVII/a/b rests exclusively in the majority of the directors and the Board of Governors. Here, as we have seen, the potential creditor countries have a preponderance.

It is to be noted that according to Article XIX/1 'payments for current transactions' which must not be controlled include, *without limitation*: (1) 'all payments' due in connection with foreign trade, other current business, including services, and normal short-term banking and credit facilities; (2) payments due as interest on loans and as net income from other investment; (3) payments of moderate amount for amortization of loans or for depreciation of direct investments; (4) moderate remittances for family living expenses

The Fund may, after consultation with the members concerned, determine whether certain specific transactions are to be considered current transactions or capital transactions.

This article, somewhat incongruously entitled 'Explanation of Terms,' is presumably also to be re-interpreted by the Executive Directors and the Board of Governors. It suffers from an internal contradiction; 'without limitation' is usually interpreted as without limits, but (3) and (4) provide for 'moderate' transfers in those categories, that is to say, for *some limitation*; the limits must be finally decided by the competent authorities, i.e. the creditors themselves.

The cumulative result of this paragraph, and of the rules concerning the capital export by potential scarce currency countries will presumably not merely mean that the alienation of assets of the debtor countries would have to be tolerated, but threatens, after the alienation has taken place, the cumulative *further worsening* of the balances of payments of the debtor countries, until the scheme breaks down.

More than that. The scheme apparently prohibits the scrutiny of foreign transactions; thus it is difficult to see how the control of capital exports can be effective in spite of Article VIII/2/a and b. Fictitious sales at fictitious prices, the most usual form of the illegal export of capital, could not be stopped. If, moreover, devaluation is—falsely—regarded as the main method of achieving readjustment,

balance of payments will have to be accomplished by cutting imports rather than by attempting to increase exports. It will not be worth while to obtain foreign supplies if the price of our exports is low, the price of imports high, and it thus becomes cheaper to produce commodities or subsidies at home. A multilateralism with a deflationary bias will lead to increased autarchy.

monetary policy could be stultified by anticipatory current transactions which could not be prevented under this clause. It is somewhat difficult to understand how those authors of the Plan who were experts versed in the practical problems of exchange control could have assented to this.<sup>1</sup>

One further point must be added. The domicile of the main office of the Bank is to be in the territory of the country with the largest quota, i.e. the U.S.A. From the point of view of prestige this is understandable and unavoidable. It is nevertheless regrettable. American economics have recently developed against a background far removed from the conditions, social and economic, in which by far the largest majority of humanity is unfortunately forced to dwell. The doctrine of economics is susceptible to the influence of immediate background and problems. The influence of the general scientific atmosphere towards misguided orthodoxy will be reinforced by exposing the Bank to an existence in the floodlight of the American Press which, in the words of the *Economist*, 'with their constant search for the melodramatic and their love for surface detail such as personalities, and for external forms, such as votes and quotas,' 'gave a wholly distorted picture of the Conference, not untainted by their proprietors' political views,' and 'whose telegrams read, to an Englishman, more like crime reports than serious accounts of what is going on.'<sup>2</sup> Can one expect that in such an atmosphere the personnel can keep the views and requirements of the majority of the member countries constantly in mind, especially if, as is provided in XII/4, the Managing Director will presumably not be the national of one of the smaller and poorer areas. The selection of the domicile and personnel has a paramount importance, as all will agree who had any intimate knowledge of the spirit and working of the different international organizations established after the last war in different parts of the world.

Nor would the tribulations of a member cease by withdrawing from the Fund. Contrary to the Joint Statement,<sup>3</sup> which envisages

<sup>1</sup> Contrary to Cmd. 6519, Explanatory Notes, op. cit., ibid., p. 4, para. 7.

<sup>2</sup> The *Economist*, August 12, 1944, p. 213.

<sup>3</sup> Cmd. 6519, op. cit., ibid., p. 4, para. 5 'Finally, if a member feels unable to accept a decision of the Fund on this or on any other matter, it is entitled under VII/1 to withdraw from membership without notice and without penalty, apart from an undertaking under VIII/2 to liquidate any outstanding obligations to the Fund within a reasonable time. Thus no member is under any obligation to continue its adherence to the conditions of membership if it comes to the conclusion that, taken as a whole, they are no longer to its advantage.'

that a member country can 'withdraw from membership without notice and without penalty,' Article XI/1 imposes certain obligations on members of the Fund with respect to their relations to non-members which would render it impossible, once the agreement is concluded, to establish regional arrangements by withdrawing from it unless all other members with which such regional agreement is to be established also leave the Fund. While this provision is understandable, it must well be borne in mind that it is easier *not to join an agreement* than to *withdraw under a cloud and to persuade others to follow*.

## 5. FOREIGN INVESTMENT AND THE WORLD BANK

The second Committee of the Conference under the chairmanship of Lord Keynes has evolved a plan to establish an 'International Bank for Reconstruction and Development.' This Bank is to have an authorized capital of \$10,000 million, of which 20 per cent shall be paid or be subject to call. The Bank under Article IV/1 'may make or facilitate loans which satisfy the general conditions of Article III in any of the following ways:

- (i) By making or participating in direct loans out of its own funds corresponding to its unimpaired paid-up capital, surplus and reserves, subject to Section 6 of this article.
- (ii) By making or participating in direct loans out of funds raised in the market of a member, or otherwise borrowed by the Bank.
- (iii) By guaranteeing in whole or in part loans made by private investors through the usual investment channels.'

The *direct* loans of the Bank may thus reach, by using the permission given in (ii), \$10,000 million. It is, however, to be expected that loans given at the initiative of the Bank will only amount to \$2,000 million, i.e. the paid up or callable capital, and the rest will be used to guarantee loans privately floated. Under Article III/4/7 'loans made or guaranteed by the Bank shall, except in special circumstances, be for the purpose of *specific* [our italics] projects of reconstruction or development.' An elaborate mechanism is to be created to ensure that the loan should only be used for the *specific* purpose. In the case of guarantee (not of direct loans) no restriction is to be applied on the expenditure of the proceeds of the loan in

the country where it was raised. In the case of direct loans, however only currencies of the countries are furnished where the expenditure takes place, though under Article IV/3, in exceptional circumstances, the borrower can be furnished with his own currency, foreign exchange, and gold. The Bank can also provide the members in whose territory the loan is spent with gold and foreign exchange. These extraordinary complicated provisions are devised to ensure 'the soundness' of the loans. No such rules can guarantee the soundness of loans. The soundness depends not merely on the specific project on which the loans are spent, but on the policy of the creditor countries. If the creditor countries pursue an employment, monetary and commercial policy which does not permit the emergence, eventually, of an import surplus, no 'banking' rules can be signed to avert bankruptcy.<sup>1</sup>

Nor can the Bank be expected to lighten the problems of countries such as Britain or France. Foreign loans, indeed, might lead to a further worsening of their terms of trade, and thus aggravate their balances of payment. This is certainly no argument against international co-operation in achieving, by a considered policy of international investment, an accelerated rate of economic development in poor and under-populated countries. It merely should not be argued that an otherwise unsound international multilateral currency scheme should be accepted because the establishment of the World Bank will render readjustments unnecessary or easier for this country. As a measure of aid to this country, unlike the scheme proposed by Messrs. Kalecki and Schumacher,<sup>2</sup> the establishment of the World Bank as now proposed is of doubtful, if not of negative, value.<sup>3</sup>

<sup>1</sup> The 'soundness' of nineteenth-century loans was ensured by the fact that on the one hand the investment led to a rapid increase in production of primary products, and on the other hand that these were eagerly absorbed by the lending countries. Neither of these two conditions of the success of nineteenth-century foreign lending obtains at present, or is likely to obtain in future. In spite of the exceptionally favourable circumstances, large parts of foreign investments were defaulted upon in the last century.

<sup>2</sup> 'New Plans for International Trade,' *op. cit.*, pp. 29-30.

<sup>3</sup> Under the proposed scheme, in case of 'direct loans' by the Bank the borrower receives the national currency of the country where it intends to spend the loan. With respect to the consequent exports of that country, the exporter does not receive foreign exchange. The Bank may (Article IV/3, *cf.* above) in exceptional circumstances provide the exporting country with foreign exchange if the expenditure of the loan within its territory results in increased import, i.e. additional foreign exchange requirements. Under no circumstances would the expenditure of the loan help in the existing balance of payment problems. So far

It may be doubted, however, whether the particular approach to the problem of foreign investment will redound to the maximum benefit of even the devastated and under-developed areas which it is aimed to achieve. One of the present writers has attempted to demonstrate<sup>1</sup> that the present-day problem of foreign investment, unlike that of the last century, is not the opening up of 'vast open spaces' but the supplying with adequate capital of over-populated territories, poor in capital equipment, and to a large extent even in natural resources. The problem of industrialization of these areas presents a basically different task from that attempted successfully in the last century. Where *single* projects might be hopelessly uneconomic or risky, a coherent plan of industrialization in which each project helps the other<sup>2</sup> may still be needed, and possible to accomplish. Foreign finance, however, as we have pointed out, can only be used if a reasonable assurance is available that the monetary and employment policy of the would-be creditor countries will be adjusted to allow the smooth transfer of interest and repayment.

In the absence of such assurance the method proposed by the Bretton Woods Conference has distinct dangers, especially for the countries whose balance of payments position is in any case weak. As *all* countries guarantee the new loans, a default (which is the *laissez-faire* solution of the transfer problem in case the creditors do not co-operate in making repayment possible) will involve not merely the strong creditor countries, as in the last century, but indiscriminately *all* countries, whether the result of the default is merely unfavourable or positively disastrous for their own monetary and international economic position. In so far as the new World Bank would take the place of the existing national export finance institutions, its general effect on the world economic stability must be regarded as doubtful.

In the last decade before the war it was recognized that foreign finance—long and short term—should be performed by governments, as only governments could provide the money at rates of

as the 'indirect loans' guaranteed by the Bank are concerned, as it is provided that the proceeds of these loans can be spent anywhere, they may to some extent help the existing Bank in the solution of the balance of payments problems

<sup>1</sup> Cf. Balogh, 'Some Theoretical Considerations on Post-War Foreign Investment,' *Oxford Economic Papers*, 1944

<sup>2</sup> The establishment of, say, a shoe factory will help in increasing the demand for, say, textiles, and vice versa.

interest which will not be destructive to the long-run solvency of the debtors.

The present plan tries to revive the *private* issue market, while introducing government guarantees. It is questionable, however, at any rate so far as *indirect* loans are concerned, which are apparently to form the greater part of the total loans of the institution, whether what can be obtained in the long run will prove to be at reasonably low rates of interest, especially if 1 to 1½ per cent guarantee commission is to be paid to the Bank. Even if Article IV/10 enjoins the Bank and its officers to act on the basis of economic considerations only, this exhortation, whatever its effectiveness, does not bind the banking houses responsible for the issue of the loan to the public. Here again too many hostages were given to future political development.

*All these objections are overshadowed, however, by the insufficiency of means.* \$10,000 million appears to be a large figure. It should again be contrasted with the size of potential export surpluses which may become necessary if full employment and thus the smooth working of a quasi *laissez-faire* system is to be safeguarded. It is interesting to recall that in the post-war decade American long-term loans amounted to \$10,000 million, while Britain lent another additional \$6,000 million. The catastrophe of 1929 was, however, not averted. In any case, the proposed 'safeguards' render these limits largely illusory.

## 6. CONCLUSIONS

This review of the proposals of the Bretton Woods Conference suggests:

1. The proposals designate *political sovereignty* as the *sole* criterion of international *economic* unity. The areas under single sovereignty are the consequence of haphazard historical development with no relevance to economic requirements. Unless full political union is achieved, regional economic arrangements between politically and economically inter-dependent units such as the British Commonwealth and/or Western Europe are made virtually impossible.

2. The proposals render *autonomous employment* policies by countries faced with instability abroad *impossible*, unless accompanied



by extreme national autarchy or complete government monopoly of all foreign trade and payments:

- (a) they provide short-term international credit facilities only, and these in insufficient quantity at extremely onerous terms;
- (b) depreciation is wrongly regarded as a means of readjusting *all short-term* disequilibria in the balance of payments, i.e. including those due to deflation and depression abroad;
- (c) persistent creditor nations are *not* discouraged to continue the policies which resulted in their acquiring *persistent* surpluses in their balance of payments. The rationing of scarce currencies, a solution which in any case was restrictive in character, but at least put *some* pressure on creditor countries, has now been so weakened as to be completely inoperative;
- (d) the scheme endangers the existence of the sterling area by enforcing the control of capital movements *within* that area, and by enforcing a complete blocking of sterling balances;
- (e) it outlaws reciprocal purchase agreements drawn up in terms of money, and thus handicaps industrial countries with large import requirements;
- (f) it leaves the decision over the ending of exchange controls after a transitional period in the hands of foreign and not altogether disinterested authorities.
- (g) it facilitates the cumulative alienation of British assets.

Unless, therefore, comprehensive and satisfactory assurances can be obtained that effective foreign demand will be stabilized, and that commercial policy will not be so restricted as to make satisfactory long-term supply arrangements impossible, the ratification of this instrument threatens to result in a perpetuation of international business cycles and/or unnecessary non-discriminative national autarchy, and a fall in the British standard of life. Unless, moreover, the safeguards about the continuance of the sterling area are reintroduced, it fatally weakens the British Commonwealth and Western European countries.

## II

### THE CONCEPT OF A DOLLAR SHORTAGE<sup>1</sup>

ECONOMISTS of the orthodox school<sup>2</sup> hold that the acute demand for dollars 'is merely a consequence of the fact that many countries are unwilling or unable for one reason or the other to live within their means. The propensity to spend and to inflate is so strong that the equilibrium in the balance of payments is constantly upset.'<sup>3</sup> The opposite view, i.e. that the rise of the United States through two world wars to a position of pre-eminence has created problems of an unparalleled character, is dismissed by a pained imprecation: 'Evidently even in the land of Adam Smith, Ricardo, Marshall, and Keynes it is necessary to point out again and again that trade is governed by comparative not by absolute cost!'<sup>4</sup> The possibility that the United States might undersell the rest of the world, if perhaps not 'all along the line,' over a sufficient range to create large-scale disequilibrium and impose unemployment, is regarded as rank heresy. It is argued, therefore, that inflation outside the United States should be stopped, and currencies devalued. 'Equilibrium' would then be restored, and all would be well.

These complex arguments continuously switch between 'pure' theoretical considerations and advice of the most highly practical character. Professor Haberler's 'equilibrium' position, implicitly taken as an 'optimum,' discloses his view of the nature of the 'world economy' which underlies his policy recommendations. It demands that a country's international payments (perhaps excluding capital flight<sup>5</sup>) should be made to balance without any direct controls over

<sup>1</sup> Published in *The Manchester School*, 1949

<sup>2</sup> Professor Haberler, 'Dollar Shortage,' in *Foreign Economic Policy for the U.S.*, ed. S. Harris, Harvard, 1948. Also Professor H. Ellis, 'Dollar Shortage in Theory and Fact,' *The Canadian Journal of Economics and Political Science*, 1948, p. 358.

<sup>3</sup> Haberler, *op. cit.*, p. 435. Identical views are expressed by Mr. MacDougall, 'Britain's Foreign Trade Problem: A Reply,' *Economic Journal*, 1948, esp. p. 92, also R. Harrod, *Are These Hardships Necessary?* p. 42.

<sup>4</sup> Haberler, *op. cit.*, p. 436

<sup>5</sup> Professor Haberler at some points gives the impression that even capital flight should be permitted ('Dollar Shortage,' *op. cit.*, p. 430). He rejects the current balance as a measure of disequilibrium, insisting on what he calls the current balance minus 'Equilibrating capital movements'. It is, however, difficult to attach any significance to this emotive concept. Capital movements even from high to low interest rates areas might well be 'disequilibrating,' in the sense that they permit the maintenance or intensification of 'disequilibria'. They end in bankruptcy. In any case, whether or not a country's borrowing is 'sound,' so much depends on the creditors' subsequent policy as to rob the concept of 'equilibrating' capital

payments, without quantitative restrictions, and without 'resorting to crude protectionist policies which, even if they succeeded in alleviating transitional strains, would do so only at the cost of permanently impeding the international division of labour and preventing the optimum allocation of resources.'<sup>1</sup>

The proof which has to be furnished by Professor Haberler in order to establish his case is not whether the United States is able by retaliatory action to enforce convertibility and non-discrimination. No one doubts that threats by the United States with her overwhelming military and economic power would be effective. *The problem is whether there is any ethical justification for the United States to use her power to enforce the rule of the unfettered price-mechanism on other countries.* An attempt will be made in this paper to show that the 'model' which underlies Professor Haberler's policy recommendations has no conceivable relation to the world we live in.

Let us first turn to the so-called long-run problem, i.e. disregarding, for the moment, monetary disturbances. We need not suspect Professor Haberler of having a physical maximum in mind when he discusses the goal of his policy: though the phrase 'optimum allocation of resources' might be interpreted in the sense of the point yielding maximum physical product, in the sense that the same output could not be achieved with less effort or a greater output with the same effort. This concept has no economic relevance without reference to the distribution of the product. Should he think of maximizing some quantity of 'utilities' or reaching 'higher' 'indifference levels' his difficulties are not less. Only if the following conditions were fulfilled—as they patently are not—would his optimum have any meaning (and we shall see not much meaning at that):

1. The original endowment of the units participating must be given, unchangeable by policy and *distributed optimally* (whatever that may mean). There must be full employment.
2. There must be *given* tastes and technical knowledge in the widest sense of the term: they must not be subject to alteration by conscious policy involving international trade.

movements of all sense. Efforts to combine a 'real' (barter) equilibrium analysis of foreign trade based on absolute factor immobility with monetary analysis (usually through a primitive quantity theory) in the hope of obtaining a truly dynamic theory are doomed to failure. Cf. below (2) on the importance of the path of readjustment

<sup>1</sup> op cit, p. 440.

3. Perfect competition must prevail within (and between) countries; moreover, there must be free internal mobility of factors.
4. The relatives between social and private costs must be proportionate and must not be influenced by risk induced by foreign trade, i.e. comparative advantages must be large and unchanging.<sup>1</sup>
5. Absolute international immobility of all factors including capital.

If these conditions are not fulfilled, 'non-discrimination,' commercial and monetary, would certainly not bring about an 'optimum.'

The first condition is certainly not fulfilled because—quite apart from any other difficulty—of the vast increase, during the war, of inequality of opportunity and means between the United States and the rest of the world. Professor Haberler confounds total and marginal conditions and neglects increasing returns. He also falls into the pit, against which Marshall warned, of failing to inquire into the distribution of original endowments. Indeed, one might say that almost any position which resulted from some discriminatory action turning the terms of trade of the United States against her would seem to fit the description of 'optimum' better than that which would be brought about by 'non-discrimination.'

Moreover, and this is perhaps even more important, every single one of the other conditions required to justify Professor Haberler's 'optimum' is violated in such a way as to load the dice cumulatively in favour of the United States. Thus the 'optimum' of Professor Haberler and his colleagues must be rejected as false.

The concept of a *definite* 'long-run equilibrium,' 'towards which the system is tending,' is itself subject to the gravest doubt. Professor Haberler, as we have seen, invokes high authority for, instead of proving, his dictum that it is *comparative* and not absolute costs which determine trade. If taken literally, this statement is obviously untrue. Comparative costs are unknown to entrepreneurs or governments conducting trade. They act (in the absence of direct controls) on the basis of *money prices* and *exchange rates*. It is wholly

<sup>1</sup> Quite apart from anything else, tariffs must not be imposed by the (temporary) surplus country against an increase in imports. There is no suggestion that the U.S. will not protect itself against depreciation. The I.T.O. certainly permits raising tariffs in this case.

illicit to assume that *money prices* are proportionate to *long-run social real costs*. We know that private money costs are not proportionate to social real costs, and neither are prices proportionate to private money costs. Moreover, it is illicit to assume that the free market system possesses an inherent mechanism which would restore proportionality between these three sets of variables, i.e. maintain full employment. Comparative costs might be said in any meaningful sense to determine foreign trade only if equilibrium in the sense of conditions (2)–(5) of the previous section has *already been reached* and *therefore no balances arise in the current account of any participating country*. But these conditions rob the argument of such relevance as it might still possess.

If a large-scale disequilibrium has arisen the concept of the eventual 'equilibrium' position has no sense *independently* of the *path* taken. Its position will be co-determined by the path of readjustment. The path itself, however, is determined by absolute costs and monetary factors. Sustained inflation (or deflation), for example, in a leading country will decrease (or increase) its competitive power and lead to structural changes (in comparative costs) which are likely to persist after the original disequilibrating effect is removed. In any case, the enforcing of secondary readjustments by the restoration of the equilibrium of the country originally responsible for the disturbance might well depress opportunity costs to zero in other countries.<sup>1</sup>

There is no earthly reason, for instance, why a country could not 'undersell another all along the line'<sup>2</sup> provided loss of reserves takes place on the part of the deficit country. The short-run elasticities, which seem extremely low (whatever they may be in the long period), will further impede readjustment, and may result in substantial lowering of the standard of life—through a worsening of the terms of trade—of those on whom readjustment is imposed, i.e. of the dominated, i.e. the weaker, economies.

The dominant economy in addition might cause a further and unnecessary lowering of the standard of life of its partners by imposing unemployment through employment effects inseparable

<sup>1</sup> Cf my article 'Exchange Depreciation and Economic Readjustment' in *Review of Economics and Statistics*, 1948, pp 277–85, and J. J. Pollak, 'Exchange Depreciation and International Monetary Stability,' *ibid.*, 1947, pp 173–82.

<sup>2</sup> Cf my paper 'The U S and International Economic Equilibrium,' *op. cit.*, as well as Professor Samuelson, 'Disparity in Post-War Exchange Rates,' *ibid.*, p. 407.

from the price-movements,<sup>1</sup> income effects, which could have been avoided had different, more discriminatory means been used to restore the balance in international payments.<sup>2</sup> Any shock in the dominant economy by its multiplier effects and reactions is bound to cause fluctuations much greater in extent than the original cause. On the other hand, the repercussions of 'readjustments' on the surplus countries must not be underestimated. The richer a country, the more difficult it is for her to maintain monetary equilibrium, and the more dangerous shocks from the outside.

It is for those who from time to time exhume Say's theorem—having periodically busily interred it<sup>3</sup>—to prove that employment effects are not bound to arise and thus to effect the eventual position of 'equilibrium.' The growing uneasiness of the 'orthodox' school is reflected by the fact that they have without exception refrained from recommending the observance of the 'rules of the game' to the United States. According to orthodox canons the United States should have inflated (while the deficit countries deflate) until the resultant rise in incomes and prices helps to wipe out her surplus. In this way the extent of readjustment abroad would be lessened. The realization that this procedure would have aggravated the European crisis after the war (and caused a cumulative disequilibrium in the United States<sup>4</sup>) has begun to dawn. Yet its corollary, that orthodox measures cannot minimize the lowering of the standard of life of the poorer countries, is still being fiercely resisted.

It has been argued that the cumulative processes induced by monetary 'readjustment' are merely short-run phenomena and that if protective measures are introduced the long-run opportunity costs will rise by more than the gain from the employment effect. Whether or not this is so cannot be decided on general *a priori* grounds. It will depend on the extent of the long-run comparative cost differences and of the degree of unemployment. If unequal

<sup>1</sup> On the monetary mechanism, cf. my paper 'The International Aspects of Full Employment' in *Economics of Full Employment*, Oxford, 1944.

<sup>2</sup> Moreover, if Say's law is thus dropped at any moment through the 'path of readjustment,' as it must be, comparative costs become meaningless for the 'country' suffering from unemployment opportunity cost of a commodity sinks towards zero or even below.

<sup>3</sup> e.g. Professor Haberler, *The New Economics*, ed. S. Harris, p. 173.

<sup>4</sup> As in 1927. It is interesting to see how little reference is made nowadays to the colossal failure of the Norman-Strong attempt to master a disequilibrium similar to the current problem by orthodox methods.

dynamic progress in two regions makes a periodic recurrence of the 'shifts in equilibrium' probable and thus necessitates periodic readjustments, the opposite is more likely. Moreover, the risk of such recurrence itself will undoubtedly influence 'comparative costs' retarding economic development—to the detriment of the weaker exporting nations. This was precisely what was threatening by the growing dominance and faster progress of the United States, if suitable measures had not been taken to bring about a better distribution of factor endowment between the Western countries, so gravely upset by the war.

The volume of trade—and this, for example, Professor Haberler seems to forget periodically—is the result not merely of cost differences (comparative or otherwise) but also of international lending. Lending will, moreover, tend to decrease comparative cost differences due to the inequality of original factor-endowment and thus tend eventually to reduce the *proportion* of trade to national income (though not necessarily its absolute volume). At the same time lending or grants will tend to decrease the inequality of opportunity in different parts of the world. *Thus loans or grants represent an alternative to discriminatory commercial policy as a means of reducing inequality.* Thus, *provided* grants and loans continue, a larger scope for non-discrimination would be compatible with the welfare of the less well-endowed countries. But this conclusion is entirely beyond the models of the orthodox economists which in basic matters disregard capital (and other factor) movements (though mentioning them whenever convenient for their argument).

Thus we may conclude that the denial of the problem of a dollar shortage in the sense

- (i) that discriminatory methods will lessen the required extent of readjustment of the weaker countries, and
- (ii) that discrimination will also produce a more equal international distribution of income and opportunity

are based on a model of the international economy which *a priori* excludes a discussion of the problem which the writers set out to investigate.

### III

## BRITAIN'S ECONOMIC PROBLEM<sup>1</sup>

### SUMMARY

1. The causes of the British crisis, 232. 2. Pent-up demand and inflation, 233. 3. De-control, military commitments, and the crisis, 238. 4. The elements of a solution, 251. 5. Conclusions, 262.

### I. THE CAUSES OF THE BRITISH CRISIS

THE overwhelming majority of British economists attributed the British crisis of 1947 to inflation, in its turn due to budget deficit and to the artificial lowering of the rate of interest. In their view this stimulated excessive investment, and also caused a diversion of resources to the production of non-essential goods. It 'emptied' the economy of working capital and led to a fall in productivity. The measures taken by the Government—direct controls limiting imports and enforcing higher exports, reduction in investment and increases in taxation—were not considered sufficient to bring about balance. The policy of stabilizing wages and prices was regarded as tinkering with symptoms. The solution of the British problem must, in their opinion, be sought in the restoration of the working of the free-pricing system, the abolition of direct physical controls. This must be coupled with disinflation, i.e. the reduction of global monetary demand by a budget surplus obtained mainly by a severe cut in the subsidies now paid to stabilize the prices of necessities. Equally, investment would have to be reduced by an increase in the rate of interest and, if necessary, by taxing investment. It is recognized that unemployment would have to rise if inflation were to be avoided without controls. It is argued, however, that the increase in productivity which would result from this policy would much more than offset the loss caused by the decline in employment. The foreign balance, on the other hand, should be treated by devaluing sterling.

In the present paper an attempt will be made to show that:

(a) the purely budgetary and investment factors played a much

<sup>1</sup> Based on a paper given to the Harvard Economics Club in the spring of 1948: the author is much indebted to the Rockefeller Foundation for enabling him to visit the United States Cf note 1, p 142 above. Reprinted from the *Quarterly Journal of Economics*, 1949.



smaller part in the crisis than has been suggested, and could in any case not be controlled by the measures proposed;

(b) the record of the British Government was far more creditable than it is held to be by opinion in their own country, and that such relative failure as occurred was due to the premature de-control of important sections of the economy, not so much causing a fall in productivity as preventing a full and quick expansion;

(c) in addition, a lack of effective co-ordination led to commitments which were far beyond the capacity of the country to sustain, especially as the clamour for increased consumption—in which a number of reputable economists participated—did not permit the Government a careful husbanding of the resources set free by demobilization, tardy as it was;

(d) the restoration of the 'free' markets would not restore equilibrium internally or externally but would result in social strife and economic relapse.

The striking success of the Government in reducing the international deficit within the limits of the Marshall Aid; the worsening of the international situation; and the consequent danger that productive resources will be diverted towards armaments without a countervailing increase in foreign help, makes this a convenient moment to survey the post-war British economic development. The new phase which opens can no longer be regarded as 'post-war.' But the experiences of the period immediately following the end of hostilities should be very valuable in framing policy.

## 2. PENT-UP DEMAND AND INFLATION

The general tendency to attribute the convertibility crisis in 1947, and the continued grave difficulties of Britain, to the monetary tension, to 'suppressed' inflation; and to look for the cause of the latter in an excess of current spendable incomes, and more especially in budget policy, conceals the most important cause of our present problems even in the monetary sphere. It is true that the Government deficit was larger than suggested by the old-fashioned Exchequer statements. These treat certain capital receipts as current revenue and exclude other current payments, since they are not met through budget votes. The true deficit of the public authorities (central and local) was some £617 million in 1946 and £135

million in 1947.<sup>1</sup> It must be remembered, however, that the revenue flows most heavily in the first quarter of the calendar year (the British financial year begins on April 1) and that most of these payments are anticipated by the corporate and individual taxpayers in their decisions. If we take this into account the combined account might be said to have shown roughly £400 million of deficit in 1946 and a surplus of some £100-200 in the past year. The gross capital expenditure of the local authorities, however, increased by £122 million in 1946 to £213 million in 1947, which was only partially offset by the excess of sales of assets of the Central Government over investment (£27 and £22 million respectively). The deficit and increase in public investment was certainly below the £500 million mark even in 1946, and in 1947 it was inconsiderable. There was a dramatic fall in the Government expenditure on goods and services from £4.5 billion in 1945 to under £2.5 billion in 1946 and £2.2 billion last year. With national income running at the level of some eight billions there is no reason to suppose that it could have been to any considerable extent the cause of excess monetary demand.

The monetary (as contrasted with the production) problem is centred on the weight, and even more on the distribution, of the 'pent-up' demand, both for consumers' and for producers' goods accumulated during the war, when both individuals and firms were forced to abstain from spending. It is difficult to measure the volume of that part of the enforced accumulation of liquid resources—by no means restricted to 'money'—which was unstable in the sense that it pressed on the market. On the basis of all historical evidence we must expect that a considerable part of these reserves—however 'enforced' they had been initially—will 'settle down': the demand for liquidity has shown a secular upward trend. But how fast and how far this 'settling down' will proceed will depend (1) on the distribution of these reserves and (2) on the confidence in money. A rise in prices and a shift towards profits would—if wage-demands were not pressed successfully in consequence—undoubtedly accelerate the exhaustion of consumers' pent-up demand and the entrepreneurial demand for capital goods can be more easily controlled.

<sup>1</sup> Death duties and other tax payments out of capital are included in the revenue and are taken into account by diminishing private savings. If we exclude them the deficit becomes £729 and £298 million respectively. Most of the critics overshot the mark by including capital payments in the reckoning of the current deficit.

But wage demands are likely at full employment if prices rise. And a vicious circle of rising prices and wages might entail a mobilization of quiescent reserves. Thus curing inflation by inflation<sup>1</sup> is not devoid of grave risks, while its 'suppression' might in the end remove all need for further 'suppression' because an increasing portion of the liquid reserves will gradually be stabilized. Last but by no means least, it should be borne in mind that the 'overhang' represented a more volatile potential demand than would an excess of current income due to, say, government deficit. A sudden change in expectations might therefore change abruptly the 'monetary' background and result in deflation.<sup>2</sup>

There can be little doubt that in Britain a considerable part of the war-time savings and reserves did press on the market whenever and wherever it was not prevented by direct controls. In the case of consumers the volume of pent-up demand was estimated immediately at the end of the war at some £2,500 to 3,000 million, a multiple of the possible 'inflationary' impetus imparted by government finance. A considerable (and the most unstable) part belonging to the lower income classes must have been used and exhausted itself in raising the price of non-essentials and services (including gambling) in the past two years. But at least a third, perhaps more, still 'overhangs,' mainly concentrated in the hands of the more prosperous working and lower middle-income classes which have greater resistance to high prices. It is this, easily retractable, demand which was mainly responsible for the pressure on the consumers' goods markets. It is still by far the most important potential cause of unsettlement in the markets for consumers' goods, especially durable consumers' goods (including house-repair), the shortage of which is grave and for the purchase of which it has been accumulated.

So far as investment demand is concerned—including working capital consisting of semi-finished or finished consumers' goods—the situation is analogous. The accumulation out of the wartime reduction of stocks, non-invested depreciation allowances, ploughed back profits, excess profits tax repayments, and war-damage compensation is well over £4,000 million. The retractability of this

<sup>1</sup> As, for instance, suggested by those who wish to suppress the subsidies stabilizing the prices of necessities.

<sup>2</sup> There seems to be mounting evidence that this, in fact, has been happening since Christmas, 1947 Cf. below.

demand depends even more than the previous category on price-expectations. As long as there is a continuous upward pressure on prices this demand will contribute to it. Once that pressure ceases it might be withheld with grave repercussions on the balance of investments: for any fall in private investment must under present conditions be met by an increase in public investment in housing, etc.; and there can be no doubt that the latter—for however desirable objects—will not increase productivity as quickly as private investment in fixed capital.

This peculiar nature of the inflationary forces limits the usefulness of most of the measures advocated. Only a complete blocking and a slow release of the financial reserves could restore equilibrium instantaneously. Increased taxation alone would be offset (and might be much more than offset) by dis-saving. But measures such as complete blocking would entail chaos and unsettlement in the financial sphere. The hardship caused would be out of proportion to the advantages gained. A forced loan or a capital levy would also tend to undermine the willingness to hold cash or liquid assets with the attendant grave long-run consequences<sup>1</sup>—unless, indeed, full-scale State ownership were—as it is not—contemplated. It is very questionable, moreover, whether the smaller savings which are relatively more unstable, and therefore more dangerous, could be immobilized without serious political consequences. And the 'freezing' of capital reserves of firms would involve discrimination against the more conservative (and patriotic) firms who have 'disinvested' most. Nor can complete financial freezing in any way be regarded as a less comprehensive or administratively easier scheme than the direct control over investment.

Thus it would seem that the possible contribution of budgetary policy to the re-establishment of 'equilibrium' is much more modest than suggested by the advocates of 'monetary, global controls.' This is not to say that a budget surplus should not be aimed at. Over a period of years it would certainly help (together with measures aiming at increasing productivity) in dealing with the huge volume of liquid reserves accumulated as the result of the war. But it would be folly to hope that budget surpluses could in the short run re-

<sup>1</sup> The 'special contribution' introduced in the last budget represents a capital levy based on the income of assets held. It is, from this point of view, not without dangers, especially as voices have already been raised for its repetition as against the assurance of the Chancellor that it will be a unique operation.

establish monetary conditions which would enable wholesale decontrol without inflicting such damage on the financial structure of the country and on the standard of life of the lower income classes as to prove politically intolerable and result in an open inflationary spiral.<sup>1</sup>

Even less plausible is the argument that dear money would improve our position. Given the huge liquid reserves, the grave scarcity of productive capacity, a small increase would have been completely ineffective in checking investment or concentrating it on *short-term* improvements.<sup>2</sup> Most of the 'long' capital projects which have been recently under attack have been launched, in fact, mainly on the basis of subsidies (e.g. housing, public improvements) and not on the basis of cheap money. And a large increase in the rate of interest (as in some countries after hyper-inflation to over 10 per cent per annum) would have had devastating effects on the budget and solvency. The pursuit of ultra-cheap money was undoubtedly mistaken. But this was not because of its direct effects on the rate or composition of capital investment.

On the other hand, the importance of the implication of full employment and of the strong bargaining position of the trade unions was largely disregarded. As long as national unity is preserved the trade unions could be expected to show, and did show, moderation in pressing for higher wages. But the cruder sort of disinflationary measures proposed, i.e. the abolition of food-subsidies, derationing, and decontrol, would have ended 'fair shares,' and, as on the Continent, unleashed wage demands, thus causing an endless spiral of prices and wages. In the end such a process induces a self-inflammatory explosion. The conscious creation of unemployment to prevent this, however, was not practical politics—in Britain, under a Labour Government; and even under the Conservatives might have ended very differently (even from an economic point of view) from what its partisans seem to envisage.<sup>3</sup>

<sup>1</sup> The example of France and Italy should be a warning. The German currency reform (unless indeed speedily followed by a large-scale capital levy and the equalization of the burden of the war as well as the re-introduction of direct controls) will probably also fail.

It will be argued below that a budget surplus should also be aimed at in order to increase savings, i.e. the investment capacity of the country at full employment. Otherwise we should have to tolerate an increase in the inequality of income or continue to enforce saving by direct controls increasing the monetary 'overhang' of pent-up demand.

<sup>2</sup> And, equally, influencing consumers' decisions

<sup>3</sup> Cf. note 1, above.

We must conclude that the global monetary measures could not alone have brought about a solution of Britain's troubles or enabled her to dispense with direct controls. It was the lack of co-ordinated planning of the use of physical controls and related matters which resulted in the British crisis.

### 3. DECONTROL, MILITARY COMMITMENTS, AND THE CRISIS

The tasks before the British Government at the end of the war were truly appalling in magnitude. And the psychological background against which it had to devise its measures could hardly have been more difficult and unpropitious. (1) The British population undoubtedly suffered less in the last stages of the war than most Europeans. But the war had lasted longer and the need in 1940-41 to resist a much superior enemy alone, combined with the continued shipping crisis, had diminished consumption by some 15 per cent<sup>1</sup> and the period of deprivation had been extended. Thus the population expected an immediate and substantial relief at the end of hostilities.<sup>2</sup> (2) At the same time the state of capital equipment was such as to justify serious apprehension. Britain had entered the war in 1939 with a capital stock which was relatively inferior to that of her main competitors<sup>3</sup>—despite the recovery made after 1932. A number of interesting studies have shown the continued relative decline of British manufacture in comparison with that in the United States and even in Germany. The effects of this decline on the standard of life were largely offset in the inter-war period by a substantial improvement in the terms of trade. During the war, as we have seen, a further serious depletion and obsolescence took place, not least in working capital. In view of the loss of foreign assets and income, however, and the consequent need for increased exports, the improvement in the terms of trade could no longer be counted upon to help the country. The increase in world population and war devastation made a worsening not unlikely. In view, in

<sup>1</sup> *National Income*, Cmd 7371, p. 71, Table 21.

<sup>2</sup> This optimism was fostered by ministerial statements that productivity had risen faster during the war than in the inter-war period, statements that were to mislead a number of careful observers (cf., for example, Beveridge, *Full Employment in a Free Society*, Appendix C, p. 370).

<sup>3</sup> e.g. L. Rostas, *Economic Journal*, 1943, p. 43, and T. Barna, *Bulletin of the Oxford Institute of Statistics*, July, 1946. It is characteristic of the attitude of a broad segment of British opinion that either these facts were denied or claims advanced that the smaller output per head was more 'economic' for Britain.

particular, of the pledge given by the Coalition Government to adhere to 'free market' economics on a non-discriminatory basis in international relations, the most determined effort to re-establish the British industrial efficiency was essential, if the country's standard of life was to be safeguarded.

A substantial reserve of productive power was available, of course, in the very fact that Britain had mobilized her manpower (including women) more fully than had any country but Russia. In 1944 the Government expenditure on goods and services amounted to £5.2 billion as against £0.8 billion in 1938. Even a pessimist could hope that a cut to, say, £1.6 billion would prove feasible. This would have released some £3.6 billion gross for other purposes if no change in the volume of national output had occurred. The net gain for civilian purposes would have been considerably smaller; for, apart from Lend-Lease, Britain in 1944 incurred £0.5 billion disinvestment at home and £0.66 abroad. But even so, *ceteris paribus*, some £2.7 billion were at the disposal of the Government for the increase in consumption and net investment, or over 30 per cent of the 1938 national income (the average price level having by then risen by some 50 per cent as compared with 1938).<sup>1</sup>

Even more important could have been (especially in the longer run) the contribution due to increased efficiency. To a large extent, improvement depended on capital investment and therefore could not at first be counted upon. But a great deal could have been accomplished by methods which did not absorb scarce resources, manpower, and imports; the concentration of production on the most efficient plants, combined with double shift working; the standardization of products; the reorganization of the layout and working methods (including labour management), the rationalization of distribution, could be expected to yield handsome returns.<sup>2</sup> The spread of oligopoly and cartellization had so distorted British production that a major readjustment was necessary. At the same time the restrictive practices of trade unions and obsolete wage-systems which hindered efficiency also had to be altered. In many key industries, among which coal is notable, their unfavourable

<sup>1</sup> D. Champernowne, 'National Income,' *Bulletin of the Oxford Institute of Statistics*, May, 1946.

<sup>2</sup> The most important firm in chocolate manufacturing estimated the increase in productivity as a result of the wartime introduction of some of these measures at well over a quarter.

effect on production is considerable. Altogether, a coherent and determined effort at industrial reorganization might, even in the short run, have increased physical output by between 10 to 20 per cent. This represented another £500 to £1,000 million at 1945 prices.

Had the Government succeeded in mobilizing this output-capacity, the British problem could by now, in the main, have been solved. It is quite clear, however, that this is far from being the case, despite the generous help received from the United States—which, moreover, consented to waive those onerous conditions which first threatened to reduce its effectiveness.

Having regard to the extremely adverse conditions which Britain faced immediately after the war, her record of productive effort is more than creditable. The return to peacetime production demanded a huge redeployment of manpower and considerable changes in equipment. Even a well-provided economy would have taken some time for a full peace effort. And the British economy

## BRITISH INDUSTRIAL PRODUCTION

				<i>London, Cambridge<sup>1</sup> Economic Service</i>	<i>Central Statistical Office</i>	<i>European Commission</i>	
				1946=100	1946=100	1946=100 <sup>3</sup>	
					1935 weights	1946 weights	
1935	..	..	..	100 <sup>2</sup>	88	95	
1936	..	..	.	110	97	104	
1937	..	.	.	117	104	111	
1938	..	..	..	169	98	104	95.7
1946	..	..	.	100	100	100	100 <sup>4</sup>
1947	.	.	..	109		108	110.5
1948	(1st qtr.)	..		120	..	119.6	..
	(2nd qtr.)	..		120.6	..	121.6	..
	(3rd qtr.)	..		113.3	..	113	..
	(October)	..		124	..	127	..
	(November)	..		126	..	129	..

<sup>1</sup> Excludes finished munitions.

<sup>2</sup> The weights used were the geometric mean between 1935 and 1946 weights, the difference being some 5 per cent in favour of the index with 1946 weights.

<sup>3</sup> Original base 1938.

<sup>4</sup> Last quarter extrapolated.



had no commodity reserves; it was an 'empty economy' at the *beginning* (and not as some suggest at the *end*) of the process of reconversion. The initial difficulties in the way of increased output were proportionately greater and the time needed to overcome them longer. As facts became available, charges repeatedly and vehemently made that planning caused a fall in production (charges mainly based on impressions derived from the fuel crisis which, though disastrous, lasted only a few weeks) were disproved.

After the first war—much less exhausting and devastating in its effects—British manufacturing output did not recover pre-war levels until 1929 and then only for a year.<sup>1</sup> The output of agriculture is some 6 per cent above pre-war.

There can be little doubt that a very different impression was created both at home and abroad by the general tenor of 'expert' British economic criticism of the Government's policy.

This relatively rapid redeployment and expansion of industry was made possible by continued full employment (not experienced between the two wars) and the absence of strikes. Unemployment, which in the whole of the inter-war period only twice dipped below 10 per cent (and then very slightly and for a few months) was reduced to less than 3 per cent. The loss of working days as a result of industrial disputes was 2.2 million days in 1946 and 2.4 million in 1947. In the first post-war period it had been 36.3 millions in 1919, 28.9 millions in 1920, 82.3 millions in 1921, and 19.7 millions in 1922. Continental countries which have decontrolled their economy show similarity to the first post-war pattern in Britain, especially in the number and duration of strikes. The increase in productive power of Britain as a result of avoiding them (apart from their adverse influence on general productivity) amounts to 1-2 per cent of output.

Nevertheless, a much greater effort would have been needed in order to restore the balance of the British economy, and this effort might have been made. The reasons for this relative failure are only partly in the field of economic policy and even there they were only partially within the power of Britain to remedy.

1. In the *international* field two reasons were important; the

<sup>1</sup> League of Nations, *Industrialization and Foreign Trade*, 1945 Annex A, p. 140. The somewhat earlier recovery of national real income must be attributed to the change in the terms of trade in favour of Britain. U.N.O. *European Economic Commission Report*, p. 11. Relative levels comparable to the present were achieved only after fifteen years in 1936.

military and other external commitments of the Government, and the unfavourable turn in the terms of trade.

(a) The first of these not merely inflicted a loss of foreign exchange, but resulted in a massive absorption of manpower. In the middle of 1946 still just over 2 million men were in the armed forces as against less than half a million in 1939. To this has to be added some 0.3 million industrial staff employed by the services and an administrative staff of almost 180,000 as against 165,000 and 52,000 in 1939. Another 715,000 were working for the services in industry in 1946. Even by the middle of 1947 these numbers only diminished to 1.3 million, 277,000, 146,000, and 450,000, respectively. The unsettled conditions of the world no doubt demanded a higher force than in pre-war years. But it is arguable that immediately after the war the danger of a new outbreak was less, and the longer-run strength of the country depended on a sound industrial base. On the average the tardiness of demobilization cost the country in the two years some 1.5 million man years, or some 5 per cent of national output. Relative to the United States—especially in terms of investment capacity—this represented a multiple drain on resources.

In 1946 the direct burden of the Government commitments abroad was £564 million or £194 million larger than the deficit in the balance of payments. In 1947 this fell to £374 million, while the deficit rose to £630 million or £256 million more than Government expenditure. The indirect burden in terms of lost production might be estimated as at least £700 million, in these two years. The total burden was therefore well over the whole of the loan from the United States and Canada. No doubt some of this expenditure could not be avoided, but it would not be over-optimistic to claim that at least a large part could have been used to diminish our foreign deficit. This would have enabled Britain to use the United States loan to improve her capital equipment and replenish her stocks of raw materials and manufactures and thus accelerate the expansion of production. The cumulative effects of this can hardly be overestimated, for a small increase in total production means an appreciable narrowing of the gap.<sup>1</sup>

<sup>1</sup> A further important cause of the loss of foreign exchange was the export of capital and repayment of war-debt. The latter has been especially sharply attacked and exceedingly high figures—up to £450 million—have been bandied about in the critical months after the suspension of convertibility. As a matter of fact, net repayment of sterling balances in the

(b) The second factor which has retarded progress towards international balance was the worsening of the terms of trade. Until 1944 these were practically unchanged as compared with pre-war. Since then Britain has experienced a deterioration of some 12 per cent, mainly as a result of the decontrol in the United States and the subsequent open inflation in the world markets. Had prices been unchanged as compared with pre-war the adverse balance of visible trade in 1946 would have been transformed into a surplus of almost £100 million and the deficit in 1947 decreased from some £440 million to less than £150 million.

Although this movement undoubtedly explains some of Britain's difficulties, it should not be attributed to temporary circumstances alone, and thus justify complacency. As it will be argued below, it does not as yet reflect the adverse turn due to the war in the *basic* relations of manufactures to primary products. It is still rather more favourable as yet than it was in the boom years of 1937 and 1929; and as the prices of primary products are notoriously more volatile than those of manufactures, the adverse shift could have been expected in conditions of world-wide prosperity. Even if the exceptional shortages and high prices due to the European crop failure in 1947 will be eased and with it the short-run position of Britain improved, in the long run severe pressure must be expected on prices of manufactures as Europe and Japan revive.

The Government has failed—except for the so-called groundnut schemes and some contracts of the Ministry of Food (e.g. the Canadian wheat purchase)—to use bulk-purchase methods to help in solving this problem. Merely to centralize purchasing will remain a somewhat risky game in Britain in view of the fact that the selling countries might also adopt this expedient and they are in a better

two years 1946 and 1947 amounted to only £100 million, a very small amount if we consider that the balances amount to some £4,000 million, and that most of them belong to poor countries in strategically vital areas. The suggestion that these balances could be wholly defaulted upon and the gold reserve (partly accumulated with the help of those countries who own them) exclusively used to maintain a (higher) British standard, seems unreasonable and certainly incompatible with either the restoration of London as an international monetary centre or the possibility of further borrowing in this exceedingly cheap manner. Somewhat more questionable is the *legal* export of capital to the sterling area amounting to more than £300 million in the same period. Some of this was necessary for colonial reconstruction, but much of it was a 'legalized' capital flight. And the relative laxity of the exchange control has made possible a substantive *illegal* flight of capital (mainly through understating export and overstating import values and through the sale of assets at less than full value). The control has now been tightened. Many loopholes were the direct consequence of the restoration of convertibility which made an adequate check of balances impossible.

bargaining position under present circumstances to extort high prices. What was needed was the positive use of long-term guarantees to provide greater security to the producers by offering long-term contracts, and thus obtain favourable prices and stimulate an increase of the total supplies of primary products.<sup>1</sup> Most of the contracts, however, were for a year only and they covered mostly commodities already exported by the same areas prior to the war. Moreover, the Government agencies responsible for bulk purchasing were recruited from 'existing trade channels' and worked through them. The checks on the policy of these 'mixed' agencies, implied in the normal competitive pressure, disappeared. The result was, in many instances—especially food—the worst of both worlds.<sup>2</sup>

2. The main *internal* causes for the failure to expand production fast enough to meet the external drain were partly connected with the manpower policy followed, partly with the inability to press for industrial reorganization. Progress in both fields was much impeded by the traditional resistance against reform of both employers' associations and trade unions, which was the direct consequence of the disastrous interwar depression.

(a) Working population shrank considerably (apart from its partial unproductive absorption discussed above), from 21.5 millions in 1945 to 19.9 millions in March, 1948. The working week also decreased from a standard 48 hours towards 40-44 hours.<sup>3</sup> The two together account for over 10 per cent decline in potential maximum productive effort.

Part of this loss was inevitable. During the war married women and old people entered production, and their partial retirement was unavoidable. Relative wages of women have not improved—another sign of the inadequacy, from a national point of view, of collective bargaining—and taxation acted as a strong disincentive. The rate of retirement was greater than it need have, or ought to have, been. The decline in hours worked, which certainly had been excessive during the war, was also to be expected. Unfortunately, the push for a sharply reduced working week, and not merely for a reduction of the excessive overtime, was far greater than was either

<sup>1</sup> The discontinuation of the long-term bulk purchase of non-ferrous metals and other supplies has resulted in prodigious losses for Britain.

<sup>2</sup> Cf., for a more detailed discussion, my article on the 'British Balance of Payments,' *Bulletin of the Oxford Institute of Statistics*, Vol. 9, No. 7, p. 223

<sup>3</sup> Cf. *Annual Abstract of Statistics*, No. 84, 1935-46.

expected or compatible with a quick recovery. This is another instance where the strong bargaining position of the trade unions was not deflected by timely action to the benefit of the whole community.

(b) Apart from this serious loss of potential productive capacity, the Government consented to a rapid abolition of controls over manpower. Not merely was industrial conscription ended—a comprehensible and desirable step—but all measures enabling an *indirect* influence on the distribution of manpower, e.g. the provision that workers could only be engaged through official labour exchanges, and the restrictions on employers, were also withdrawn. The failure, in the name of non-interference with 'free collective bargaining,' to establish relative wages in accordance with the requirements; and the failure to reform obsolete wage-systems, which militate against increased effort; combined with the relaxation of physical controls<sup>1</sup> over production and raw materials, retarded production. The monetary tension which tended to suck productive factors towards the 'luxury' industries, which were not, or not as strictly, controlled as 'essentials,' thus caused a maldistribution of the labour force. Essential industries remained undermanned and—especially in coal and consequently in steel—acute bottlenecks originated, constricting the effort of the whole community.<sup>1</sup> Added to the lifting of controls under the last Churchill Cabinet and continued by the Labour Government in 1945–46, was the anxiety of the latter to avoid even transitional unemployment. Instead of enforcing as quickly as possible the once-for-all adjustment in the distribution of manpower necessitated by the reconversion to a peace-economy and more especially by the need to pay for imports by exports, the existence of the 'pent-up' demand was permitted to stabilize employment in unessential but more congenial occupations.<sup>2</sup> This need not have involved much or lengthy unemployment. The creation of vested interest in the 'new' (gadget) industries made subsequent action much more difficult.

<sup>1</sup> Immigration was not sufficiently early and adequately tackled. The unions in some important instances at first refused to admit foreign workers for fear of renewed unemployment.

<sup>2</sup> The stimulus to the provision of electric appliances by reducing the purchase tax charged on them and providing scarce raw materials at a time when the insufficiency of generating plant was obvious, was one of the more glaring instances. The decontrol of material allocation in the textile trade was responsible for the clothing muddle in 1948 when stocks accumulated. In consequence, the home consumption of textiles was permitted to increase despite the fact that textiles remain one of the most remunerative exports. Cf. below

(c) In contrast to the handling of the problem of obtaining a suitable *relative* wage level, the Government was successful in preventing a runaway increase in *absolute* wages. The rise in wage rates from 150 in mid-1945 (September 1939=100) to 170 at the end of 1947 was certainly not cumulative and to some extent represented the readjustment due to the cessation of the wartime overtime. In this success both subsidies and price-control, the abolition of which was demanded by the critics, played a vital part. It has to be admitted, however, that an even earlier stand or at least an educational campaign against pressing for general wage rises would have been salutary.

(d) The post-war decontrol had other unfavourable effects. Certain consumption-goods industries had been rationalized during the war by closing down some units and concentrating production on the more efficient plants or on factories whose manpower could not easily be used for the war-effort.<sup>1</sup> The Coalition Government, not taking into account the problem of the balance of payments, promised to end these concentration schemes after the end of hostilities. This promise was not reconsidered despite the continued need to use manpower as fully and as efficiently as possible. In consequence an already inadequate manpower was spread over a greatly increased number of factories hardly any one of which could be manned fully. Overhead costs rose and output per man declined. In cotton spinning, e.g. one of the most important bottleneck industries, this decline was over 10 per cent.<sup>2</sup>

(e) Price control was considerably relaxed over a wide field. This, as we have already mentioned, caused a diversion of effort towards the non-controlled, unessential sector where profits rose. Where price control was retained, it was based largely on a cost-plus basis or on the cost of the least efficient firms. This destroyed incentive for greater efficiency. Moreover, in many important fields, Government intervention took the form of 'voluntary gentlemen's agreements.' All this strengthened the hand of trade associations;

<sup>1</sup> Unfortunately most of the concentration schemes were not effected by forming temporary holding companies as advocated by those who foresaw the probable post-war crisis, but by inter-firm agreements which did not safeguard the goodwill of the firms which had to close down. Consequently the hardships involved by continuing it would have been much greater. But even in the soft-drinks industry, where no such hardship was involved, deconcentration was permitted.

<sup>2</sup> Characteristically the deconcentration of petrol distribution was announced on almost the same day on which petrol allocations for private motoring were suspended altogether because of the convertibility crisis.

and the collusive administration of controls between government and industry further increased the oligopolistic and monopolistic features (already very ominous before the war) of the British industrial system.

Scarce resources were allocated with reference to the consumption in a base period—generally 1938 or 1939—which had no relevance whatever to the present position and even less to the solution of the problems facing Britain. The entry of new firms was prevented or made more difficult. The rigidity and inefficiency of the system thus further increased. The restoration of 'consumers' choice' in these conditions in effect meant the restoration of the producer's domination and his success in creating, through product differentiation, 'secure' markets, and increased the number of models and types, produced at the cost of efficiency and competitiveness. The relaxation of controls, moreover, resulted in a reduction of stocks in 1946 with unfavourable consequences on productivity. The coal crisis was only the most dramatic of these.

The British problem cannot be judged on the basis of United States experience. The eager striving for greater labour saving so characteristic of the United States remains almost completely absent in Britain. The self-restraints in British industry cannot easily be comprehended elsewhere. If the statutory attack on monopoly was largely unsuccessful in America the rather feeble attempts in Britain have no chance of success. Only an energetic combination of price-controls based on the cost of efficient producers, of compulsory standardization, and of concentration, aided by suitable raw material allocation policies based on efficiency, could enable Britain to overcome her industrial handicaps without a severe deflationary crisis. There is no time to rely on the increase of efficiency through an extensive investment programme. In Britain the results which in the United States might be brought about by decontrol and the inherent dynamism of the competitive market system could only be enforced by price and production controls. But such control needs to be far more efficient and ruthless than it has been hitherto.

(f) Nor has the Government made full use of its own legislative and social programme to promote efficiency. So far as the programme of nationalization—except perhaps steel—is concerned, it was politically pre-determined and economically not controversial. But it should have been used for far-reaching reorganization of

labour relations and of wage-systems. This did not happen. It would, moreover, have been prudent to make more obvious provision to *ouvrir la carrière au talent*. As it was, the nomination of trade union officials to high executive positions merely increased the internal struggle between the officials and the more ambitious of the rank and file, who wished to succeed them and therefore tried to outbid them for popular favour. Instead of canalizing talent towards a career within an industry through technical education, it was diverted toward political activity. The inevitable re-employment of the members of the old technical staffs, whose relations to the men had not been smooth, added to the grievances. The employment of erstwhile civil servants who found it difficult to grasp the human and business problems involved did not help. The increasing distance between the centre and the working-places—an inescapable result of the amalgamation of small units into nation-wide corporations—was not bridged by suitable direct contacts. The result was indifferent organization and unofficial strikes, which detracted from the otherwise impressive success of, for example, the nationalization of coal mines.

Nor was the large programme of internal development—especially housing and social services—used to develop the mass-production of standard goods. As we have seen, the production of 'standard' (utility) goods was discontinued over a large field. But the Government did not even use its power to guarantee large markets to tempt manufacturers into industrial reorganization. Had, for example, the refrigerator industry been guaranteed the sale of 400,000 units over a period of years it could have cut costs to less than a third of those now prevailing. The importance of such a move for the export drive cannot be too much stressed. Altogether, it is no exaggeration to conclude that the Government has missed the chance of increasing British production by at least another 15–20 per cent—however creditable its accomplishment may be in comparison with the results achieved after 1918 or with those in European countries in which 'freedom' was restored.

(g) The combination of these factors made itself inevitably felt on exports in respect to which control was also considerably relaxed. The priority of export orders prescribed was not backed by strict raw material allocations. Nor was the licensing of exports continued. Consequently the spectacular recovery of exports from 45·8 per cent



of their pre-war volume in 1945 to 99·3 per cent in 1946 did not continue in the first half of 1947. Indeed a relapse occurred.

VOLUME OF EXPORTS (1938=100)

1945 (year)	.	.	..	.	45·8
1946 (year)	..	..	..	.	99·3
(4th quarter)	..	..		.	111·8
1947 (1st quarter)			..		100·6
(2nd quarter)			.	..	101·9
(3rd quarter)	.	..	..	..	113·9
(4th quarter)	.	..		.	118
1948 (1st quarter)	..	..		.	125·6
(2nd quarter)			.	..	134·3
(3rd quarter)	..	.			138·2
(4th quarter)	.	.	..		146·3

Moreover, exports to 'soft' currency countries, which were more profitable at the current rates of exchange, showed a substantially greater increase than those to areas from which essential food and raw-material imports had to be obtained. Devaluing sterling would not have helped under these circumstances (even if offsetting wage-increases could have been avoided and export prices increased to the maximum possible so as to avoid a violent worsening in the terms of trade), as the *relative* attractiveness of foreign markets would not have been influenced by this measure. More could have been achieved by refusing to sell except against 'available' sterling (i.e. sterling balances held by foreign countries as a result of current transactions)<sup>1</sup> or gold. And the attraction of the home market had to be countered. Despite the fall in the productive potential and the continued drain on civilian manpower, consumption was permitted to increase from 1945 to 1946 by some 10 per cent, and in 1947 increased further by another 3 per cent. It may not have recovered to the pre-war level<sup>2</sup> but the fall, even per head, is small indeed.<sup>3</sup>

<sup>1</sup> In distinction to 'old' pre-war or wartime balances.

<sup>2</sup> The White Paper estimates a slight increase but it does not however take into account quality changes and probably understates the rise in prices. Cmd. 7371, p. 41.

PERSONAL EXPENDITURE AT 1938 PRICES (£ MILLION)

1938	1944	1945	1946	1947
4,288	3,706	3,921	4,292	4,424

<sup>3</sup> Cf G D N Worswick, 'A Fall in Consumption,' *Bulletin of the Oxford Institute of Statistics* (June, 1948), Vol 10, No 6. It is interesting to compare the facts now available with the wild statements on production and consumption by the critics of the Government made while neither production nor consumption indices were available. The fact that the high income tax promotes claims for expenses which do not appear in the national income figure leads to an under- rather than to an overstatement of the productive effort.

It is the non-availability of goods which command high consumers' surpluses, the deterioration in the stock of durable consumers' goods (including houses), and the greater social equality which had to be obtained by reducing the share of the more prosperous and therefore more articulate classes of the community, which has created the impression of grave impoverishment. The supply of durable goods, including houses, increased sharply, and there was a substantial expansion in other—non-essential—services and goods—the obverse effect of the decontrol over production which has been discussed above. There can be no doubt that rationing, price-control, and subsidies to essentials created an artificial demand for non-essentials. But this does not mean that the measures taken in respect of the former were unjustified. It means that they should have been accompanied by controls necessary to maintain equilibrium.

The fact that shortages have led to the adoption of *fair shares* in the distribution of *necessities* does not eliminate the need for inequality of income to give incentive. Only the incentive is by common consent limited to (semi) *luxuries* so as not to involve hardship. It behoves an advanced community so to educate its members that discipline should be possible even without the whip of starvation. On the other hand, if such a system is established, the encroachment of unessentials on the total effort must be prevented by direct controls. The anxiety of the Government to avoid even short-term frictional unemployment was to some extent responsible for their failure to deal with this problem. The insistent demand for de-rationing and high consumption, backed by reputable experts, however, made the necessary 'austerity' almost impossible.

The Government's record is thus better than the critics admit. The alternative policies advocated would, as in France and Italy, have led to social trouble and economic frustration. The Government's failures—in a position of unparalleled difficulties caused by the war—were due to its ceding to popular clamour (to a large extent supported by the majority of expert opinion within and without the Government) both in relaxing controls over production and in permitting so large an increase in consumption. Moreover, an inordinate and invaluable period was wasted until a central planning agency was established and properly staffed. Consequently there was an inexplicable delay before it was realized that the country's external commitments were out of balance with its

economic strength, before action was taken to readjust them, and also before steps were taken to increase and secure a balance in productive capacity.

#### 4. THE ELEMENTS OF A SOLUTION

The external commitments of the country, the worsening of the terms of trade, together with the internal decontrol and the consequent misdirection of production and undue increase in consumption, led to a rapid deterioration of the current balance of payments of Britain in 1947. The loss of reserves due to incomplete control and capital exports was even worse.

U.K. BALANCE OF PAYMENTS (MILLIONS)<sup>1</sup>

	<i>Imports f.o.b.</i>	<i>Exports and re- exports f.o.b.</i>	<i>Balance on visible trade</i>	<i>Invisibles (net)</i>	<i>Total balance on current account</i>	<i>Total loss of reserves</i>
1946						
1st half	502	392	-110	-120	-230	80
2nd half	590	498	- 92	- 48	-140	146
1947						
1st half	725	511	-214	-121	-335	469
2nd half	815	591	-224	- 71	-295	555
1948						
1st half	887	731	-156	+ 16	-140	254

<sup>1</sup> H C. Deb, Vol. 456, No. 8 (September 23, 1948), Columns 137 and 138. Figures for the second half are not yet available. The dollar deficiency was more than covered by E.R.P. By the end of the year an over-all balance was more or less re-established, although the dollar deficit continues.

Despite accumulating signs of crisis (and, apparently, the willingness of the United States Government to waive the respective clauses of the Anglo-United States Financial Agreement), convertibility was introduced in July, 1947. It had to be suspended within a month. As the Administration had expressed complete assurance in its ability to fulfil the obligations which it had undertaken despite repeated warnings, confidence was severely shaken and a far-reaching reconsideration of policy took place.

It was agreed on all sides that measures had to be taken to bring effective demand and supply into a more balanced relation. The

question was whether this was to be done by global measures restricting monetary demand, while freeing both it and supply of direct controls; or was the nominal money demand to be more severely controlled, its disturbing effects on the distribution of productive resources curbed, and steps taken to increase supply by direct intervention and stimulus. In this way the pent-up demand could also be eliminated or at least sterilized. In the end, a compromise was arrived at—mainly under the pressure of political forces—and a mixture of these policies was applied. In the foreign field the strengthening of direct controls prevailed—if for no other reason because time (and reserves) were lacking to test the alternative. In the domestic field the ‘global’ measures were more predominant. It will be shown that their consequences were not altogether favourable.

In the field of foreign economic policy the retreat towards bilateralism was the more precipitate as the confidence of the experts in the soundness of the experiment in non-discrimination and unilateral convertibility had prevented any preparations of an alternative policy, and no reserves remained. Imports from the Western Hemisphere were sharply cut. Despite a further rise of more than 10 per cent in foreign prices and increasing need for raw materials due to the expansion of output, the Government managed to keep imports from rising proportionately. Controls over exports were reintroduced and the system of priority allocations was considerably reinforced. This produced a spectacular increase in the volume of exports from roughly 100 per cent of 1938, in the first half of 1947, to almost 150 per cent in the middle of 1948, an advance the rapidity and extent of which is hardly paralleled by any country.<sup>1</sup> Despite misgivings voiced, Britain did not find much difficulty in concluding a considerable number of trade and payments agreements which brought its balance of trade more into equilibrium and prevented further losses of dollars and gold. Despite (or perhaps rather because of) the dropping of convertibility, she succeeded in limiting the drain on accumulated sterling balances and in limiting the legal and illegal flight of capital. Equally important was the cut in the gross cost of foreign commitments of the Government from £564 million in 1946 to £236 million

<sup>1</sup> See table, p. 240. The figure for July, 1948, was 149. The target for June was 140, for December, 150. (*Economic Survey for 1948*. Cmd 7347, p. 8)

(annual rate) in the first half of 1948, and in net cost from £291 million to £114 million. As the foreign income of the Government was temporary, the cut in gross cost was essential. Altogether the foreign balance improved from a deficit of £335 million in the first half of 1947 to only £140 million in the first half of 1948. This was all but within the limits of the Marshall Aid which had in the meantime been put into execution by the United States, thus effectively reversing the American foreign economic policy hitherto pursued. In the second half of 1948 a further considerable improvement took place.

The British domestic economic policy also underwent considerable, though less abrupt, changes. These can be divided into two groups: on the one hand, the relaxation of controls was reversed, and measures were taken to limit Government commitments so as to set free productive resources. On the other hand, and mainly under the impact of the violent criticism against Government policy suggesting that the breakdown had been caused by inflation, steps were initiated to cut money demand. The 'cheap money' policy was reversed, taxation was increased, subsidies reduced, and investment projects cut.

A closer analysis shows that the former steps had a far greater effect, and, moreover, that the latter had some unfavourable repercussions.

Elaborate calculations have been made<sup>1</sup> to demonstrate that a dramatic change in the British monetary background has taken place at the turn of the new financial year (April 1 in Britain), usually accompanied by eulogies of Sir Stafford Cripps' new policy. The Chancellor certainly deserves high praise for his determination to dispel that air of unreality which surrounded the discussion of both domestic and foreign economic policy, and to call attention to the grave long-run position of the country. But the turn of events cannot by any means be attributed solely or even mainly to the change in the monetary background. The autumn budget of 1947 increased prospective revenue by some £250 million. It was harshly criticized as insufficient. Yet taxation was not further increased. The changes in taxation decided upon in the 1948-49 budget were 'inflationary' on any sensible definition: direct taxation on income

<sup>1</sup> e.g. R. C. Tress, 'The Budget and the National Income,' *London and Cambridge Economic Service*, Vol. XXVI, No. 11 (May, 1948).

was cut by £103.5 million while indirect taxation was increased by some £40 million only. The capital levy, true enough, is expected to bring in £105 million, but an overwhelming part will certainly be paid out of capital and will not diminish outlay. The change from a 'true' deficit of £432 million in the calendar year 1947 to a 'surplus' of £315 million in the financial year April, 1948–March, 1949, is certainly dramatic—almost £750 million, or little less than 10 per cent of the national income, at factor cost.<sup>1</sup> But, as we have seen,<sup>2</sup> from an economic point of view these calculations are rather too 'schematic.' It is not true, for example, that the sale of surplus stores has no 'disinflationary' effect in a position where pent-up demand is not restricted to the consumers' sphere. On the other hand, many 'capital' repayments, e.g. war-damage payments, are 'sterilized' by effective controls on capital expenditure; and income tax payments, though they fall due seasonally, are anticipated by the taxpayer in his decisions of spending. The change was much more continuous than these figures suggest and came about more through a decline of expenditure than through an increase in revenue.

The abandonment of 'cheap' money resulted in an increase of the rate of interest from roughly  $2\frac{1}{2}$  to 3 per cent on medium Government stock. This small change certainly could not influence investment decisions. Even a much greater rise would hardly have had substantial effects as the liquid reserves of firms made them independent of the capital market. It is questionable, moreover, whether in Britain at present the usual market process could satisfactorily differentiate between different projects even if it could be made effect. The relative attractiveness of different projects could only be compared by that method if prices were free. But the freeing of prices would not merely raise them well above long-run equilibrium prices but would also start a violent inflationary spiral which would render all comparison impossible. However imperfect the control of capital investment, if handled with some common sense, it serves the purpose more satisfactorily. A rise in interest rates without decontrolling prices would not reflect 'natural' relations but merely indicate differences in the price policy of the different controls. In any case, when risk is absent (as it largely is in a fully employed country) a small rise would be completely

<sup>1</sup> *ibid.*, p. 43.

<sup>2</sup> Cf. above, p. 234.

ineffective as profit margins are of a higher order of magnitude. A sharp rise, on the other hand, is impracticable for budgetary reasons.

It is sometimes suggested that 'dearer' money, by diminishing stock exchange values, at least depressed consumption power. Even this is questionable. Those speculators who were active and spent freely when prices were increasing had liquidated their holdings. The trusts and institutional holders of securities will hardly have decreased their outlay (the increase in spendable income as against capital appreciation was the much-complained-of result of the cheap money policy) as a result of a depreciation of capital. Although there were strong arguments against a *continued fall* in interest rates, their *rise* must in the long run be harmful.

Even more questionable was the wisdom of the proposal to cut investment, put forward by a section of economic experts.

Investment in fixed capital (including housing) was only £1,200 million in 1946 as against £750 million in 1938. But the price of capital goods had more than doubled in the meantime. In 1947 gross investment rose to just under £2,000 million<sup>1</sup> and was to be reduced by some 15 per cent. To those economists who claim that the *global* amount of investment was too ambitious, the answer is simple. The war-damage and obsolescence not made good was very heavy, amounting to probably not less than £3,000 million. The capital equipment continues to be exhausted by its fuller rate of utilization. The depreciation allowances even in 1938 amounted to some £450 million or some £1,000 million at present prices. The Government measure (which was a much watered form of the proposals of the orthodox economists) meant in fact a reduction of net investment to, at most, £750 million or, in terms of 1938 prices, less than £400 million, i.e. roughly equal to the insufficient investment of the slump year of 1938. This cut was administered at a time when the United States rate of investment was, on any calculation, at a record level and United States industrial produc-

<sup>1</sup> *National Income*. Cmd. 7371 In an earlier White Paper on Capital Investment the figures given were £1,550 million for the middle of 1947 and £1,600 million for the middle of 1948. These figures exclude changes in the value of stocks and only take account of certain kinds of investment in housing and industry. The cuts were to have amounted to some £230-250 million. Cf. *Capital Investment in 1948*. Cmd. 7268; H M Stationery Office. Cf. also the admirable critique, 'Cuts in Capital Investment,' by F. A. Burchardt, in the *Bulletin of the Oxford Institute of Statistics*, Vol 10, No 1 (January, 1948). The cuts were concentrated on the planned increase in road vehicles (50 per cent) while plant and machinery were to suffer less (20 per cent).

tivity had sensibly increased above pre-war, which in its turn was a multiple of the British. The campaign which suggested that hardships could be avoided and both consumption and the balance of payments simultaneously restored by diminishing capital investment was not merely based on the crude statistical fallacy of counting the factors released doubly. It also had most regrettable psychological consequences by suggesting that the crisis was of a superficial character and easily curable without discomfort now, or in the future. Nothing could have been more unfortunate.

There was, however, a more specific and less extreme criticism against the investment programme. This attacked partly the costliness and elaborateness of the housing programme. Moreover, it was suggested that the lack of central co-ordination, to which reference has already been made, resulted in an inflation of investment projects beyond the capacity to undertake them simultaneously, thus causing unnecessary congestion, bottlenecks, delay, and a decrease in productivity. The review of investment projects was rightly concentrated on limiting further schemes until those under execution were completed. This had an immediate and favourable influence. Actual cuts in investment, on the other hand, were fortunately not drastic. The suspension of new projects had, however, a discouraging effect on enterprise, the consequences of which were to show themselves subsequently. The standard of housing accommodation, however, which had been improved considerably and thus impinged on the quantity of housing which could be provided, was not reviewed and adjusted at all.

The most important factor on the monetary side was, however, the stabilization of the pent-up demand, considerably increasing the effective level of net saving. At the moment of gravest apprehension, a reduction in the prospective gross investment in fixed capital<sup>1</sup> of the country to £1,550 million was aimed at. It was thought that £700 million of this could be covered by private means, of which undistributed profits were to have provided some £225 million. Taking into account the dissaving implied in the decrease of tax reserves, this would have necessitated personal, private saving of some £450 million, a high but not impossible achievement out

<sup>1</sup> It can be argued, of course, that pre-war housing standards were too low and that it would be unfortunate to saddle the country with housing which would soon have to be improved. On the other hand, the change in the size of families had increased the demand for smaller houses



of a private disposable income of almost £9,000 million. All these calculations have been upset by the increase in private saving, the expansion of production which had not been taken into account, and the consequent improvement in the budget and in company finance, as well as by the grant of Marshall Aid. By the summer of 1948 it became likely that the surplus and capital maintenance of public authorities would be nearer to £425 million and £145 million respectively; Marshall Aid and other foreign disinvestment, £300-400 million; business depreciation allowances, £800 million. The total sum available is, therefore, £1,670-1,770 million, excluding private saving. Ploughed back profits will not be less than £350 million and might be higher. Thus £2,000 million of gross investment could be financed *without* any private saving. The Government plans foresaw only £1,550 million of investment including all investment financed out of private personal saving. Private saving would hardly be less than £250 million (it was £450 million in 1947). Thus the flow of savings and the investment capacity of the country was gravely underestimated.

The combination of the agitation against austerity, against controls, and against investment had prevented or retarded the preparation of investment plans to make immediate use, for an increase in productive investment, of such unemployment as might arise, since the advisers of the Government still thought in terms of runaway inflation. Nor had the redeployment of labour been organized with sufficient care and thoroughness. The Government was therefore forced to retreat, both on the cuts in consumption and in investment; especially since the suspicion of the trade unions had been aroused, partly by the rise in prices (due at first mainly to increased taxes and the cut in subsidies, but subsequently to the rise in foreign prices), and partly by the propaganda against 'over-full-employment,' which was directed mainly against their strong bargaining position. Subsidies were increased from an annual rate of £390 to £470 million, thus decreasing the budget surplus. The clothing ration was increased and certain items (shoes, furniture) altogether de-rationed.<sup>1</sup> The home supply of other goods was also permitted to increase. This meant a loss of potential exports. The housing programme was restored to almost its original volume,

<sup>1</sup> The accumulation of stocks, which forced this measure, was also the consequence of the decontrol over the allocation of raw materials, which led to a misdirection of supplies. Cf. above, Part 3

and the maintenance of 200,000 houses under construction is envisaged instead of only the contemplated 120,000. Much more serious was the decision to increase the limit of house repairs permissible without licence from £10 to £100 per annum per house—a measure which might increase the volume of non-essential and unproductive investment by some £150–200 million, a drain not easy to support.

Thus the ‘disinflationary’ programme had the paradoxical result of diverting goods, which should have been exported, to the home market and of absorbing in house repairs resources which should have been used to increase *productive* investment. Of course, it could be (and has been) argued that the Government should not have yielded to the political pressure resulting from unemployment and loss of domestic trade and should have maintained pressure on demand until all readjustments had been made and the ‘essential’ industries been manned. This argument is reinforced by a plea that decontrol of domestic prices, the cut in subsidies to the price of essentials, and devaluation would have further reinforced the effectiveness of the deflationary policy.

The case for devaluation is completely fallacious as long as no resistance is encountered in export markets, since it would turn the terms of trade against Britain. Britain imports food and raw materials which have well-organized markets and world prices and she exports manufactures which are subject to market imperfections. For this reason, a worsening in the terms of trade might be serious enough to offset any stimulus to the volume of exports. Imports are, in any case, held well below their ‘free’ level and their quantum would not be affected by devaluation. The rest of the argument is even weaker. In order to obtain a margin in favour of export prices as large as is maintained at present by controls (the index of average export values is at 251 (1938=100) as against a domestic wholesale price index of 218,<sup>1</sup> mass unemployment of a severe kind would have to be created.<sup>2</sup> This fact is hardly ever faced by those who argue that controls are a ‘blunt’ weapon, incapable of working efficiently.<sup>3</sup>

<sup>1</sup> This comparison is not strictly justified because the export index is based on part of the exports only. But it is indicative of the position.

<sup>2</sup> An even greater degree of unemployment would be required to balance foreign trade without quantitative controls.

<sup>3</sup> So much also for the fashionable view that bilateral agreements do not increase foreign trade under certain circumstances. British capacity to import was safeguarded and increased

Similar considerations must also lead to rejection of the domestic aspects of this policy. The unemployment required to accomplish the necessary shift of manpower without controls and without a conscious wage policy would be so high as to lead to a breakdown of the policy of co-operation between the unions and the Government. A 'slight disinflation' would certainly not have sufficed. The advice to raise prices by decontrol and the reduction of subsidies would, far from leading to deflation and a shift into export industries (because people would have less money to spend on non-essentials), lead to violent wage demands and increase the inflationary impact. Moreover, under those conditions the holders of liquid reserves would no longer hold back: an explosive cumulative process might ensue.

The rejection of this policy by the Government was amply justified by the fact that the maintenance of social peace and the expansion of production contributed far more to the better balance between supply and demand than any other factor, a fact often slurred over in discussion of the British problem.

Industrial output increased in 1947 by 8 per cent over 1946. But the improvement was most striking in the last quarter of the year, which ran some 20 per cent above the 1946 average. In the first half of 1948 this advance was maintained. The consequent increase in supplies can be put at some £1,000 million at wholesale prices and the increase in the supplies for civilian purposes at £1,300 million, or almost double even the *nominal* cut in monetary demand in consequence of budget policy (the *effective* cut was much less<sup>1</sup>). The diminution of Government expenditure abroad was matched by a decrease in domestic expenditure. Including only that on goods and services (i.e. excluding transfer payments) this decreased from £4,495 million in 1945 to £2,473 million and £2,168 million,

by the hurriedly negotiated (and therefore somewhat too restrictive) trade agreements after the breakdown of the unilateral convertibility, which in its turn resulted in a competitive restriction on British exports in the futile effort to obtain dollars from her. It must be admitted, however, that a number of complications might arise (not the least because of the need to spread overhead cost over a sizeable home market) which have as yet not been faced. The end of the sellers' market would aggravate these problems because decisions would have to be reached as to how far to permit sales at home of products unsaleable abroad (at any rate for a period needed to readjust production). But for all this, the strong pressure exercised by priority raw-material allocations for exports and by the control of domestic prices is proven by the extraordinary expansion of the volume of exports in a period of full employment at home, an expansion which belies the doubts expressed by the 'disinflationists.'

<sup>1</sup> Cf. above, p. 254.

respectively, in 1946 and 1947, with a further expected drop of some £100 million in 1948. Hence there has been a substantial release of manpower for productive work of well on to 1.5 million, or almost 10 per cent, since the middle of 1946, and 0.4 million since the middle of 1947, which became effective only after a certain lag. The production available for export and domestic civilian purposes thus increased even faster than total output.

These achievements were partly the automatic consequence of the process of demobilization and reconversion. But to a large extent they were due to the gradually accelerating reversal of the decontrol initiated during the Coalition and Conservative Governments in 1945 and continued by the Labour Administration. It was at last recognized that the maintenance of full employment necessitated planned intervention if inflation was to be avoided; and that Britain's international balance could not be regained without undue and unnecessary sacrifice (and thus the risk of social strife paralysing production, as happened in some Continental European countries), if direct controls were not strengthened. As it was the pressure of events, rather than conscious policy, which brought this change about, it came rather belatedly, and after precious time had been lost.

The control over employment was restored. This does not mean industrial conscription. It merely means that instead of the power of the purse combined with the whip of unemployment, an intelligent and discriminatory influence is exerted on employers' hiring policy. The charge that slavery is about to be established in Britain has been exposed to the ridicule of facts. At the same time, the pressure for higher wages which had been growing in 1947 has been checked by voluntary co-operation on the basis of a Government statement.<sup>1</sup> The most important cause of an inflationary spiral was thus stopped. The whole outlook now hinges on the success of this policy. Should the voluntary system fail, some sort of statutory power will have to be used. Unfortunately, less attention was paid to establishing a relative wage structure which would help, rather than hinder, the redeployment of labour, and little success has been achieved in reforming the outdated wage system so as to maximize incentive.

<sup>1</sup> The increase in wages was to some extent a result of reconversion to peacetime production. As wages in the 'shrinking' industries could not be lowered, those in the 'undermanned' trades had to be raised. But the process threatened to assume a cumulative character.

A further increase in prices would obviously end all hopes of stability. The diminution of the subsidies to the price of essential goods, combined with the rise in world prices, has already put a grave strain on labour relations. Any further cut, which seems still to be favoured by some, would certainly unleash violent wage demands and inflation.<sup>1</sup> For the same reason the extension of control over the price of non-essential goods is an essential factor of recovery. True enough, the Government is only groping towards an effective policy on prices. Control is still based either on cost-plus or on the cost of the less productive firms. It is, moreover, in many cases still only 'voluntary,' and therefore precarious, often exploitative and often inefficient. But a beginning has been made, and it is to be hoped that a steady pressure will be exerted on the oligopolistic and monopolistically competitive price structure which had such fatal consequences on British efficiency between the two wars.

Domestically the policy will be tested by its success in increasing production, and this can only come from increased productivity.<sup>2</sup> Since the first half of this year not much progress has been made. While all agree on the need for higher efficiency, neither the Government nor the two sides of industry seem willing to undertake the necessary reforms with vigour. Apart from intensified investment, which is of longer-run influence only (and which depends on whether the Government is strong enough to resist demands for increased consumption), efficiency could in the short run be increased by technical changes, such as better layout of factories and the standardization and concentration of production. Some experiments have been made with good results (e.g. in cotton spinning), but they remain on a small scale. Nor has there been much progress made in establishing industrial development councils—the organization of which was permitted by an Act already two years on the Statute Book—which could undertake this task. The resistance encountered by the proposal to set up an Anglo-United States joint advisory council to explore the problem shows a disturbing spirit of complacency, and a reluctance to face facts.

<sup>1</sup> This has been recognized by the Government. The food subsidies, which according to the budget speech were to have been limited to £400 million, have lately been increased to £470 million. Cf. my paper on 'The Abolition of Food Subsidies,' *Bulletin of the Oxford Institute of Statistics*, November, 1948.

<sup>2</sup> On the methods of increasing productivity, cf. Part 3

Nor was there much accomplished by way of reforming obsolete systems of pay which reduce incentive and thus obstruct progress.

The worsening of the international situation and the consequent drain on manpower and production is a renewed threat to recovery, especially in relation to the foreign balance. That aspect of the British problem is now dominated by United States policy and the Marshall Plan. An increase in physical production which would restore the balance in foreign relations by 1952 is well within the limits of British efforts. But the conditions which might be attached to United States aid might easily endanger the balance of payments.<sup>1</sup> The time has not yet come to discuss the probable consequences of an almost simultaneous cessation of aid to European countries, with the entry into force of the non-discrimination clauses of the I.T.O. Charter (not to speak of the obligation to maintain convertibility which has not been formally abandoned), as the formation of a Western European payments and trading area might profoundly alter prospects. Although the basic condition of recovery, social peace, has been preserved (despite the demands to pursue a policy leading to unemployment and a fall in real wages) and substantial progress made towards a reintegration of Britain into a more balanced world economy, the future of British recovery still hangs in the balance.

## 5. CONCLUSIONS

These considerations suggest that criticisms of the policy of the British Government, coupled with demands for decontrol, disinflation, and devaluation are not substantiated by a closer analysis of the economic developments in the country, and of the problems faced by it. These criticisms were based mainly on hasty impressions created—in the absence of reliable and up-to-date statistics—by the fuel crisis of 1947 and on theoretical misconceptions of the nature of the inflationary pressure. Moreover, they ignore the social implications and thus the indirect economic consequences of the (monetary) measures advocated. The reconsideration of the salient determinants of the British economic position also suggests the directions in which a solution could be found.

<sup>1</sup> For a more detailed discussion, cf. my articles 'Exchange Depreciation and Economic Readjustment,' *Review of Economics and Statistics* (November, 1948), and 'Discrimination' and 'Intra-European Clearing,' *Bulletin of the Oxford Institute of Statistics*, Vol. 10 (1948), Nos. 7, 8, and 9.

1. There was and remains general agreement that the relationship between *effective* monetary demand and supply has to be brought into balance, and thus the international balance of payments restored. The dispute on British policy centres on the *method* of readjustment only and not on the aims to be attained. The choice is between an attempt to return to a 'free' market system on the one hand, and a strengthening of direct controls in order to prevent a misdirection of resources, on the other. We have seen that in the short run, decontrol, deflation, and devaluation could not bring about effective monetary balance, not merely because of the much greater relative volume of wartime pent-up demand in Britain as compared with the United States, but also because stocks of commodities are still extremely low and cannot be increased because of the balance of payments crisis. This disparity would inevitably start a cumulative inflationary spiral once controls were removed. The scarcity of stocks would accentuate the inflationary momentum by encouraging speculation. By maintaining controls and speeding the increase of productivity on the one hand, and by budgeting for a surplus on the other, the pent-up demand might be eliminated in the longer run. This demand will also tend to press less on the markets as supplies begin to increase, and as hopes rise of being able to purchase in the future on better terms. The volatility of the pent-up demand enjoins careful planning in handling deflation, as otherwise unemployment might be caused suddenly if liquidity preference rose, and the manpower set free might not be absorbed in undermanned industries and in investment. The consequent political pressure might result in an undue increase in consumption (including durable goods). Conclusions drawn from an analysis of the British or European position, however, are not necessarily applicable elsewhere.

2. The inflationary spiral in Britain (and in many other parts of Europe) would almost certainly become explosive in the absence of controls if unemployment were not extremely heavy, for otherwise wage demands would be pressed home and the bargaining power of the trade unions would be too strong. It is fallacious to assume that the level of unemployment which is needed without controls (a) to keep wages stable, (b) to stimulate exports, and (c) to balance international payments, is identical and equal to the level of unemployment which is inevitable as a result of people passing

from job to job. This is far from being the case. The tighter the trade union organization, the larger the 'industrial reserve army' needed in an uncontrolled economy to maintain monetary stability. 'Disinflation' cannot be 'successful' in the sense of permitting *decontrol* without creating *unemployment*. The social consequence of a deliberate policy aiming at maintaining a large industrial reserve army such as the 'disinflationists' advocate, would be incalculable. It is noteworthy that all European countries which attempted to re-establish a 'free' market economy have menacing Communist movements. In contrast, those countries (mainly Scandinavia, Holland, and the United Kingdom) which have controlled systems have escaped social strife. Once the working class is organized and the realization spreads (through the popular acceptance of the Keynesian view) that the level of employment is not an unalterable consequence of the interplay of natural forces, the basis for the functioning of 'free' markets is undermined (except perhaps in countries which possess an agricultural reserve population or in which technical progress is high enough to set free workers at the rate required to maintain relative stability without distress, e.g. the United States).

3. The success of such 'disinflation' as there has been in Britain seems due to accelerated demobilization and a reduction of foreign military commitments. Thus productive capacity increased substantially. Moreover, controls were reimposed and the distribution of manpower adjusted. The continued wastage through absorption in non-essential production was effectively limited. The inflationary pressure was relieved by the voluntary agreement of labour not to press for higher wages. This agreement was based on the maintenance of relatively stable prices and the continuation of the policy of full employment and social reform. It is unlikely that the consent of labour could have been obtained on other terms.

Indeed, when the pressure of pent-up demand abated and when unemployment threatened, the Government was forced by the consequent political pressure to reverse its deflationary policy. This was the case both in consumers' goods (clothing, furniture, house-repairs) and in producers' goods (factory building). In consequence the opportunity to increase productive capacity and exports was lost. More careful planning might have avoided this misdirection of effort. The Government has not solved the once-



for-all problem of the large-scale shift of manpower which arose as a result of reconversion to peace production. The relative maldistribution of manpower will therefore have to be relieved slowly. But no such problem is likely to arise again (unless war breaks out). The lesser day-to-day readjustment required by shifts in demand can be handled much more easily.

4. If the suggestion that decontrol, combined with monetary measures aimed at reducing real effective demand, could solve the British short-run problem, ignores the social, and thus the indirect economic, consequences of the policy proposed, it is perhaps even more to be criticized from a longer-run point of view.

(a) The abolition of key controls (as contrasted with their gradual relaxation and the reduction and simplification of control) would seem to require the permanent maintenance of a large reserve of unemployed. A co-ordinated wage and price policy, coupled with measures to steer workers into occupations where they are most needed, and with a control on the hiring policy of employers, will reduce this wastage through unemployment.<sup>1</sup>

(b) But apart from the elimination of instability, it is fallacious to argue that decontrol in Britain would restore a perfectly competitive price structure and accelerate capital accumulation and economic progress. The British economic problem in this respect differs basically from that of the United States. All evidence points to the conclusion that decontrol would result in the continuation of trends towards monopolistic restrictionism which are responsible for the present inadequacy of British capital equipment and for inefficiency. Anti-monopoly legislation could not restore a workable system, for it cannot deal with such tacit agreements, which have been prevalent in Britain.<sup>2</sup> Moreover, the need for increased efficiency would seem to depend on a technical reorganization of industry involving large-scale amalgamations, concentrations of production, and standardization of products. Such large-scale changes are hardly practicable (and would certainly not be undertaken) without Government intervention. This should be both positive, e.g. stimulus through guarantees of sales, provision of

<sup>1</sup> Cf (2) above

<sup>2</sup> This would also affect the problems of stability, as fewer workers would be freed by technical progress ('technological unemployment'), and, as (unlike the United States) we have no manpower reserves in agriculture, the maintenance of monetary equilibrium (difficult enough even in the expanding economy of the United States) would be entirely dependent on a substantial degree of unemployment. Cf. (1) and (2) above.

capital (either finance, or building and leasing of factories); and negative, e.g. pressure on excessive profit margins through maximum price limits. The threat of control and nationalization has already had very salutary effects in, for example, the steel and automobile industries. Moreover, such reforms could not be put into effect without the closest co-operation of the trade unions. This would not be forthcoming in Britain without some Government safeguards for the workers. It is not an exaggeration to conclude that *controls are needed in Britain to enforce efficiency*. Investment must also be speeded up. Voluntary savings are unlikely to be forthcoming in sufficient volume to sustain the required volume of investment without a considerable increase in the inequality of income distribution. Such a reversal of social policy would, however, be incompatible with the aims of the Government and with social peace and monetary stability: wage demands would certainly follow on any step which increased profits. While some tax-reform encouraging the ploughing back of profits (especially by young and smaller firms) might be carried through, the increase in savings will, in the main, have to come through the maintenance of a substantial budget surplus. This should not be used for 'disinflation,' as some have proposed, but for an increase of the investment both by the publicly owned sector and—through finance companies—also of private firms. Positive State intervention will have an important role to play in reconciling a more equal distribution of income with the need for quicker economic progress.

5. Britain—and no doubt certain other European countries—must look for her salvation to an improvement of the existing system of controls and to their co-ordination on the basis of a coherent plan. This was acknowledged with great foresight by the United States Administration of the Marshall Aid Programme when it demanded the submission of detailed four-year plans from the recipient countries. In the last year considerable progress has been made in both directions. The Government has also begun to harmonize financial and physical controls. Much still remains to be done. Price controls and raw material allocations must be thoroughly reformed to stimulate efficiency. Obsolete wage systems also remain to be altered in order to improve the incentive to effort while maintaining monetary stability. There is grave danger that the fear of resentment will drive the Government further towards

a 'tripartite' administration of controls, or in other words towards a collusion with well organized pressure groups on both sides of industry not dissimilar to the 'corporative' state. This would hinder an increase of productivity from its present unsatisfactory level, since reforms enforcing its increase would no doubt run counter to vested interests. Britain needs more information and far more publicity to improve both the work of planning and that of intelligent criticism. Much can be learned from the United States in this respect.

6. The long-run prospects for the British balance of payments cannot be reviewed in this context.<sup>1</sup> It will depend chiefly on factors which are beyond the control of the British Government, especially on the position and policy of the United States. It is obvious, however, that quantitative controls of imports and direct stimulus to exports through domestic price control and priority raw material allocations, must be maintained. The Marshall Plan vouchsafes a certain breathing space. It will have to be used—in conjunction with the internal reorganization—to establish a strong and efficient economic system in Western Europe and in those overseas countries with which Western Europe has special political ties and which are in the main complementary to its productive structure. Such close co-operation must thus take the form of preferential arrangements which permit the rationalization of British and Western European industry and the expansion of its markets overseas. While the Marshall Plan insists on the need for such—discriminating—use of European supplies for European reconstruction, there is no indication as yet that the United States realizes that these arrangements cannot come to substantial fruition before the expected end of the aid programme (1952), but must be continued for a considerably longer transition period. Only in this manner can the ruptured multilateral system of world trade, based on the export surplus of Europe to tropical and sub-tropical areas and the import surplus from North America, be restored. It is also questionable whether the flimsy structure of reconstruction could survive a cessation of United States grants, without other non-U.S. areas (at least non-European) being enabled by loans or U.S. import surpluses to buy European products against dollars. Criticism of the British Govern-

<sup>1</sup> Cf. my articles 'Discrimination' and 'Intra-European Clearing,' *Bulletin of the Oxford Institute of Statistics*, Vol. 10, Nos. 7 and 9, and 'Exchange Depreciation and Economic Readjustment,' *Review of Economics and Statistics* (November, 1948), esp. Part IV.

ment in this respect has become widespread and it is suggested that it hinders the establishment of Western European unity. This criticism is not understood in London and arouses violent resentment. The fact is that the British ministers and experts (apart from the legitimate doubts about formal customs or federal unions) are still labouring under the concepts underlying the abandoned policy of non-discrimination. It is not that they wish to hinder progress towards closer co-operation, but that they lack the burning conviction needed to establish a co-ordinated plan for Western Europe, and to carry it through by sheer moral leadership against mounting technical obstacles due to the open inflationary or deflationary disintegration in many European countries.

7. The task before the British Government is formidable. There are no short cuts to its solution. But however distant the goal, the real achievements of Britain must not be ignored. The talk about falling production and muddle is refuted by the facts, which show that output is 25 per cent above pre-war and still rising. The real danger to continued British recovery must be considered to lie mainly in the threat of renewed expansion of military expenditure (especially direct expenditure abroad) beyond the country's economic capacity. It is to be hoped that the Government will not commit the errors of 1945-46 once more, and that it will approach the United States betimes to consider the incidence of the cost of what is a common foreign policy. Recovery might also be checked by premature decontrol and by an undue increase of consumption permitted for reasons of internal politics. The hostile comments of British experts give a false picture abroad of Britain's effort and success, and should be refuted if Anglo-United States co-operation is to thrive.

#### POSTSCRIPT

This essay was written early in 1948 and brought up to date in September. In the months which have passed since, the triumph of the policy here adumbrated continued. Manufacturing output has increased one-third above pre-war, a record never achieved in the twenty years of peace after the first World War. An *overall* balance in international payments is within grasp. The advocates of return to free-market economics and deflation have, once more, proved completely wrong. Nevertheless, popular and 'expert' pressure and

the attraction of the 'liberal' viewpoint to the highest levels of the civil service has, as in 1946-47, led to a renewed partial reversal of the policy of balanced control. This might well weaken the force of recovery and even result in a relapse.

Thus on the domestic side the programme of the Government for the next four years submitted to E.C.A. envisages too small an increase in productivity, i.e. 15 per cent in four years, hardly more than that of the inter-war period which left Britain well behind its chief competitors. This is due in part to the failure to provide for an increasing rate, in terms of the national income, of investment, and in part to the apparent scepticism of the Government of being able to take effective steps to reorganize British industry.

Some features of the Government plans in the international field seem also questionable. (1) The recent change in the U.S. attitude opens the way to the re-establishment of a multilateral world economic system, such as was never possible under Bretton Woods; and the utmost use should be made of it. The plans published imply, however, that Britain has not yet sufficiently reorientated her policy of retreat towards bilateralism, and more particularly, that it is cutting its dollar deficit in far too mechanical a way, instead of using a fuller U.S. aid both to increase its productive investment and to promote European recovery. (2) The success of the multilateral approach implies a much greater degree of economic co-operation than obtains at present. It is regrettable that the British Government has not taken the initiative in strengthening the O.E.E.C. so that it can fulfil the task of a really effective international planning agency. (3) In the longer run multilateralism can be maintained only if some of the rules of the I.T.O. are modified and the length of the period of transition extended. Moreover, co-operation of the United States in solving the dollar problem is essential, including toleration of transitional discrimination against her and one-sided tariff concessions. It also implies effective help in promoting progress in under-developed areas.

It is to be hoped that the coming months will see a thorough revision of the British four-year plan and the growing co-operation of the British and the United States Governments in extending the scope of international planning to include an effective solution of the above problems.